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GENERIC PAYMENT-IN-KIND CERTIFICATES

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

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CONTENTS

THURSDAY, MARCH 26, 1987

Page

Leahy, Hon. Patrick J., a U.S. Senator from Vermont, opening statement 1

CHRONOLOGICAL LIST OF WITNESSES

Crowley, Brian P., Senior Associate Director, Resources, Community, and Economic Development Division, U.S. General Accounting Office, accompanied by Dave Wood, assignment manager, and Jay R. Cherlow, group director, Economic Analysis Group 2
Amstutz, Daniel G., Under Secretary for International Affairs and Commodity Programs, U.S. Department of Agriculture, accompanied by Ralph D. Klopfenstein, Deputy Administrator, Commodity Operations, ASCS, and William F. Bailey, Deputy Administrator, Program Planning and Development, ASCS 23
Letter dated May 15, 1987, to the Honorable Patrick J. Leahy, from the Honorable Richard W. Goldberg, with enclosures 42
Questions from Senator Leahy and the responses thereto 43
Questions from Senator Conrad and the responses thereto 59
Letter dated June 1, 1987, to the Honorable Daniel G. Amstutz, from the Honorable Patrick J. Leahy, chairman of the Committee on Agriculture, Nutrition, and Forestry 71
Letter dated July 17, 1987, to the Honorable Patrick J. Leahy, from the Honorable Richard W. Goldberg, with enclosures 72
Questions and answers:
Generic PIK Certificates 74
The redemption of commodity certificates 77
Farm Program Fact Sheet 86
Chronology of the Commodity Certificate Program 88
Hora, Keith, first vice president, National Corn Growers Association, accompanied by Larry Johnson, chairman, Government Affairs Committee 99
Russell, Duncan, grain marketing manage., The Andersons, Maumee, OH, representing National Grain and Feed Associ.tion 102
Moseley, James, Clarks Hills, IN 104

APPENDIX

Prepared statements:
Helms, Hon. Jesse, a U.S. Senator from North Carolina 109
Crowley, Brian P., Senior Associate Director, Resources, Community, and Economic Development Division, U.S. General Accounting Office 109
Hora, Keith, first vice president, National Corn Growers Association 112
Russell, Duncan, grain marketing manager, The Andersons, representing National Grain and Feed Association 115
Moseley, James, Clarks Hill, IN 122
Neumann, Lawrence N., president, grain marketing, Benson-Quinn Co., representing the National Grain Trade Council 123
Marxman, Merrill D., president, Marxman and Associates, Inc 125
Demeter, Inc., Fowler, IN 128
Kopperud, Steve, vice president—legislation, American Feed Industry Association 130
National Association of Wheat Growers, Washington, DC, letter dated April 1, 1987, to Hon. Patrick Leahy 132

GENERIC PAYMENT-IN-KIND CERTIFICATES

THURSDAY, MARCH 26, 1987

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 2:10 p.m., in room 332, Russell Senate Office Building, Hon. Patrick J. Leahy (chairman of the committee) presiding.

Present or presenting a statement: Senators Leahy, Harkin, Conrad, Daschle, Helms, Boschwitz, and Bond.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

The CHAIRMAN. Good afternoon. The Committee on Agriculture, Nutrition, and Forestry will come to order.

I welcome you gentlemen. We are here to review what I think is a very complex, yet important subject—generic PIK certificates. I say important because I think PIK certificates seem to have brought some sweeping changes to the agricultural landscape. More than a lot of the hybrid plants and other things we may be growing. In fact, some may wonder whether it is a new crop.

In his absence, I would also like to thank my colleague, Senator Helms, for his cooperation in arranging this hearing. It was he who first asked the General Accounting Office to look into PIK certificates, and we appreciate that they can unveil some of their findings here today.[1]

When we wrote the 1985 farm bill we authorized USDA to use PIK in a number of situations. But this PIK had a new recipe. And, like the creators of the "new Coke," few of those involved realized how much this new recipe would change the markets.

It did not take the smartest producers and grain companies very long to concoct some creative ways to squeeze additional dollars from this new program.

I am not condemning PIK certificates by saying that. We have heard some good things about them. We have been told they moved some surpluses into the market, eased storage problems in a number of areas, and brought some badly needed income into depressed farm communities.

But we have also heard that PIK certificates have acted like an unauthorized marketing loan, forced corn prices down, cost taxpayers millions of dollars more than straight cash payments would

[1]See p. 109 for the prepared statement of Senator Helms.

have, and lined the pockets of a few big farmers and shrewd grain traders. We are not yet sure how much truth there is to these statements, but I receive letters concerning them all the time. People ask me about it. I was asked about PIK at our field hearings in the Midwest.

Nonetheless, USDA has already issued $5.5 billion worth of PIK certificates or, in other words, about 50 percent of the payments for deficiency, diversion, and other programs. $5.5 billion is more than the average annual cost of all the Federal farm programs through 1981. Another $7 billion in certificates could go out by this fall.

So, the hearing today is an educational one—not an inquisition or witch hunt. Our basic question today is this: Do the benefits of PIK certificates outweigh their problems?

We must know the answer to the questions in order to meet the Budget Committee's requests. They will be asking us to make cuts in some of the programs under the jurisdiction of this committee. If we are going to be required to do that to keep under budget totals, there are particular programs I want to see cut first. Some of these hearings are particularly important because they assist us in the budget process by determining a program's relative value to our agricultural system.

Gentlemen, I appreciate you all being here. Mr. Crowley, the Senior Associate Director of the Resources, Community, and Economic Development Division will speak first.

STATEMENT OF BRIAN P. CROWLEY, SENIOR ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY DAVE WOOD, ASSIGNMENT MANAGER, AND JAY R. CHERLOW, GROUP DIRECTOR, ECONOMIC ANALYSIS GROUP

Mr. CROWLEY. Mr. Chairman, I have a couple of things this afternoon. I have a prepared statement which I will ask you to submit into the record.[1]

I also have a report that was done at your request and at Senator Helms' request, which details the information that I will be presenting this afternoon.

What I thought I would do this afternoon, because the program is a rather complicated one, is prepare a briefing document and walk you through it. I think you will find it in your folder there. It is marked "GAO Briefing on Costs and Other Information on USDA's Commodity Certificates."

Mr. Chairman, this afternoon I will try to answer a few questions for you. The questions are: What are the certificates? How are they used? How much has been issued and used? How do certificates affect Government costs? How do the certificates benefit the Government, farmers, and the grain industry? And why have certificates traded at premiums?

First, what are the certificates? Essentially, they are documents that are issued in lieu of cash payments, for such things as deficiency payments. They are negotiable. They are generic except for cotton. And they are issued in dollar amounts.

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[1] See p. 109 for the prepared statement of Mr. Crowley.

How are they used by the recipients? In four different ways: they are exchanged for commodities under loan. They are exchanged for CCC-owned commodities in inventory. They are sold to USDA for cash. Or they are sold to other interested parties.

At this point I want to talk a little bit about something called the posted county price. The posted county price is what USDA determines to be the value of the commodity in a particular county. It is at that value that the certificate is turned in. That is the value of the commodity translated into the dollar amount in the certificate.

As of the end of January 1987, as you correctly pointed out, $5.5 billion in certificates have been issued. About $3 billion of those have been exchanged as of the end of February 1987. There are expected to be at least $1.8 billion to $3.2 billion issued by the end of December 1987. As you also indicated, there could be more than that because of deficiency payments that will be coming due shortly. Those could be paid in certificates.

In the document I have a few tables which will show you the certificates and where they have been issued. It is on page 6 of the briefing document. It shows you the commodities and the programs that they have been issued for: $4.1 billion of the $5.5 billion has been issued for deficiency and diversion payments.

The next schedule, on page 7, shows what the certificates have been exchanged for. Approximately $400 million has been exchanged for items in CCC inventory. The great bulk of them, however, have been used to redeem producer loans. Approximately 87 percent of the exchanges have been to redeem producer loans; 68 percent of the certificates have been used for corn; 20 percent for wheat; and 12 percent for other commodities.

[The tables from Mr. Crowley's briefing document follow:]

TABLE 1-1.—CERTIFICATES FOR DEFICIENCY AND DIVERSION PAYMENTS AS OF JAN. 31, 1987

Commodity	Deficiency	Diversion
Wheat	$1,815,615,401	$211,490,735
Corn	1,344,254,193	186,610,489
Barley	126,603,199	7,681,362
Oats	15,236,138	1,785,622
Sorghum	107,959,576	15,688,708
Upland Cotton	171,286,660	
Rice	56,010,285	
Total	3,636,965,452	423,256,916

TABLE 1-2.—AMOUNT OF CERTIFICATES ISSUED

Deficiency payments	$3,636,965,452
Diversion payments	423,256,916
Issued ethanol certificates	53,815,178
Issued export enhancement certificates	96,038,308
Targeted Export Assistance Program	35,227,722
Others	1,215,691,055
Total	5,460,994,631

TABLE 1-3.—CERTIFICATE EXCHANGES FOR CCC INVENTORY AND PRODUCER LOANS AS OF FEB. 25, 1987

Commodity	CCC inventory	Producer loans	Total
Wheat:			
Bushels	52,819,013	194,360,152	247,179,165
Value	$125,173,970	$460,607,468	$585,781,438
Corn:			
Bushels	79,036,099	1,175,077,375	1,254,113,474
Value	$129,276,010	$1,922,024,447	$2,051,300,457
Sorghum:			
Bushels	22,469,935	61,931,905	84,401,840
Value	$40,215,786	$110,843,233	$151,059,019
Rye:			
Bushels	2,200,577	1,764,248	3,964,825
Value	$3,119,417	$2,500,901	$5,620,318
Oats:			
Bushels	346,684	1,263,864	1,610,548
Value	$352,960	$1,286,744	$1,639,704
Barley:			
Bushels	25,917,809	67,321,642	93,239,451
Value	$31,671,996	$82,268,172	$113,940,168
Soybeans:			
Bushels	482,881	2,460,872	2,943,753
Value	$2,444,428	$12,457,364	$14,901,792
Rough rice:			
Hundredweight	25,227,716	18,305	25,246,021
Value	$83,478,009	$60,571	$83,538,580
Upland cotton:			
Bales		4,619,705	4,619,705
Value		Note c	Note c
Honey:			
Hundredweight		1,618	1,618
Value			
Total value	$415,732,576	$2,592,048,900	$3,007,781,476

Mr. CROWLEY. By the way, as a share of the total producer loans, corn producer loans and redemptions are increasing as a share of the total.

How do the certificates affect Government costs? In several ways: we have reduced costs, and we have increased costs, good news and bad news. The reduced costs are obviously the cash outlays for certain farm programs such as the deficiency payments and for the diversion programs.

Also, you are going to have reduced storage costs. However, you are also going to have increased net cash outlays for CCC price support loans. Those increases will be direct and indirect. Let me tell you how.

I have an example that I discuss on page 9. This is a hypothetical example. It says, the loan rate for corn in Fowler County is $1.84 per bushel, and the PCP—which is the posted county price—is $1.50 per bushel. Farmer Brown, a dairy farmer, grows corn but usually does not place it under loan because it is needed to feed the cows. However, Farmer Brown can place the corn under loan and immediately exchange a $1,500 certificate for it at the PCP, making it available to feed the cows as usual. Farmer Brown places 1,000 bushels of corn under loan and immediately exchanges it for the $1,500 certificate. Farmer Brown keeps the $1,840 loan pro-

ceeds and feeds the corn to his dairy cows. The increase in outlays due to the certificates is $1,840.

You also have an increase in net loan outlays when a farmer who would normally pay off his loan in cash exchanges a certificate for it instead.

To give you an idea of the indirect costs, I have example 2. Essentially, indirect costs mean that the supply of free stocks will be increased. Increasing supply will usually force market prices down. In this case, Farmer Brown's neighbor, Farmer Green, also exchanges a $1,500 certificate for 1,000 bushels of corn under loan and markets it. With the relatively low market price, PCP, Farmer Green would have, in the absence of certificates, placed the corn under loan and then forfeited the corn to CCC. In this case, certificates have resulted in an additional 1,000 bushels of corn available to the marketplace, and the market price for corn declines somewhat. A price decline induces another farmer in a neighboring county to place an additional 900 bushels of corn under loan.

You also have an indirect effect when grain companies buy CCC-owned stocks rather than buy the stocks from free supply.

The indirect effects of certificates are to increase the amount of the free stocks or supply; more goes to market. The increased supply causes prices to fall. When market prices fall, more commodities are placed under loan, and more loans are forfeited. Net loan outlays are thereby increased.

After looking at all the available data relating to the $3 billion in certificates that have already been exchanged as of the end of February 1987, we have come up with estimates as to what the reduced cash outlays will be, the reduced storage and the increased net loan outlays.

With regard to reduced cash outlays, the figure is $2.983 billion. That is less than $3 billion because of the Gramm-Rudman effects.

Reduced storage we estimate will be between $169 million to $253 million. However, increased net loan outlays will be $3.09 billion to $3.636 billion, as a result of the direct and indirect effects.

The overall conclusion is that the certificates are costing more than cash.

How do the certificates benefit the Government? Well, the objectives of the certificates were about five. One was to minimize cash outlays, and I have just talked a little bit about that. Net loan outlays will increase. But it has shifted the outlays from fiscal year 1986 to fiscal year 1987 and beyond. In the long term, however, we believe there will be a higher cash outlay.

The second objective was to reduce CCC inventory and loan stocks, and there may be a small reduction in inventory.

Enhanced market competitiveness, it has definitely increased the competitiveness of corn. Corn prices are lower. Domestic consumption is somewhat higher. And exports are expected to rise by the end of this year.

The CHAIRMAN. Are expected to, but have not yet.

Mr. CROWLEY. Correct.

Senator HARKIN. Could you repeat what you just said there? Did you just say that the PIK certificates had the effect of lowering the price of corn?

Mr. CROWLEY. Yes, sir.

Senator HARKIN. Thank you. I just wanted to make that clear.

Mr. CROWLEY. By making more of the commodity available to the market, it then dropped the price.

The CHAIRMAN. But it has not had the effect of increasing exports yet?

Mr. CROWLEY. Not yet. Exports usually lag a year or two behind price changes. So, probably if it does have an effect, it will be toward the end of the year.

The CHAIRMAN. The end of this year?

Mr. CROWLEY. Yes.

The CHAIRMAN. Thank you. Go ahead, Mr. Crowley.

Mr. CROWLEY. There are reduced storage costs primarily in the short term. The certificates exchanged for 1985 corn in the Corn Belt, by the way, relieved a severe shortage problem in that area; and so there were some benefits to the Government on that.

Permit easy access to CCC loan stocks, which was another objective of the program for USDA. It has also done that. The grain companies who otherwise would not have been able to buy CCC stocks now have access to them.

Farmers also benefit from the certificates. They benefit in several ways. There are increased returns under the loans because storage costs are avoided. Farmers can go to CCC, place the grain under loan, immediately exchange certificates for it, and thereby avoid storage costs. If they had to wait until the end of the 9-month period, they would have to pay storage costs for their commodity.

It also increases returns when they can sell them for cash at higher than the face value to other farmers who can use—or to grain companies—who can use the certificates.

Sometimes they can market grain at a price higher than the PCP. This occurs because the PCP is a county-wide price, and there can be places in the county where the market price is higher than the PCP.

How do the certificates benefit grain industry? First by giving it greater marketing opportunities. The certificates can be exchanged any place in the country where CCC makes grain available. There is an opportunity to profit on the differentials between the PCP's and the actual market prices, and farmers have the same opportunity.

They also can act as intermediaries in trading certificates and profit from the exchanges through either a premium differential, or use them as a marketing device whereby they would attract business to the grain companies.

Why have the certificates traded at premiums? There are two factors that would decide whether and how much the certificates will trade at premiums: supply, which is decided by USDA and the recipient's willingness to trade; and demand, which is determined by the benefits provided to individual farmers and others.

If you go back to page 9, where I talked about Farmer Brown, who had a $1,500 certificate, which he was able to redeem for corn that he had put under loan at $1,840, you can see that the certificate has a value to Farmer Brown. If he did not have a certificate, he would be willing to pay more than $1,500, say $1,750 for that certificate because he could still make money on the deal.

Mr. Chairman, our observations on our work are generally that the certificates likely have and will cost more than cash, but they also have substantial benefits primarily for the farmers and industry, less so for the Government. But farmers, I believe, pretty much like these.

There is, however, a potential budgetary reporting issue. That is, that under current budgetary reporting procedures, certificate amounts are not included in the budget outlay totals at the time of issuance, even though they ultimately have effects similar to outlays. This may lessen the usefulness of the budget and its reported outlay amounts to the Congress in its budget-related deliberations and actions.

The proper budget treatment of certificates is a complex and technical matter but one which the Congress may wish to study further.

Mr. Chairman, that summarizes my prepared statement this afternoon. I would be happy to answer any questions you might have.

The CHAIRMAN. Thank you.

Do either of the gentleman with you, in the couple of minutes remaining, have anything he wants to add? If there are any matters that your expertise does not cover, Mr. Crowley, will they take care of them?

Mr. CROWLEY. Yes.

The CHAIRMAN. Thank you.

You spoke about a budgetary problem, that the certificates are not truly reflected in the budget or listed in outlays. This raises a question in my mind. By a somewhat similar token, could the use of these certificates allow some producers to receive a net benefit above the limits being set by the Congress? For example, for cotton and rice producers, there is a payment limit of $250,000. Because of what they could make off the certificate, could someone receive more than that $250,000 limit?

Mr. CROWLEY. I am not sure, Mr. Chairman. I could look into that for you.

What we did in this study was quantify the cost of PIK to date. We also have another job ongoing for this committee, which is to look at the administration of the program itself. That would be one of the questions we would look into.

The CHAIRMAN. I wish you would. Specifically, is it possible to use PIK certificates to exceed a congressionally-mandated limit? Secondly, do you find any such instances of that in your study?

Another question I have is this: the Congressional Budget Office has proposed changing this program. They would require current loans to be paid off at the loan rate rather than at the posted county rate price. They estimate a savings of $1.4 billion over 5 years with such a program modification.

Do you agree with that?

Mr. CROWLEY. Mr. Chairman, I heard about that proposal just before I sat down in this chair. I really have not had time to think about it. I would have to think a little bit more about that one.

The CHAIRMAN. I understand. Some of the questions that we will be asking here may well require an answer for the record. Each of the Senators will be free to do that.

I yield to the Senator from Iowa.

Senator HARKIN. Thank you, Mr. Chairman.

I just wanted to follow up on that price question.

Mr. CROWLEY. Yes, sir.

Senator HARKIN. You said that it had the effect of depressing the price. Do you have any quantifying numbers on that? Do you have anything at all that would show how much this might have worked—any numbers at all?

Mr. CROWLEY. Let me have Mr. Cherlow answer that.

Mr. CHERLOW. Senator, we do not have any firm number on that. Many factors go into setting price. It is hard to isolate one factor such as certificates and attribute how much of the price decline is due to that versus how much is due to other factors.

There is general agreement, although not unanimous, that there has been a price effect.

Senator HARKIN. Let me then ask a follow-up question, on the increased costs to the Government of PIK certificates. You did point out that PIK certificates do have the benefit of lowering the storage costs which is a cost, of course, borne by the Government?

Mr. CROWLEY. Yes, sir.

Senator HARKIN. Did you factor that in when you said it still increased Government costs?

Mr. CROWLEY. Yes, we did.

Senator HARKIN. So even over and above the savings that we got from less storage, it still costs more?

Mr. CROWLEY. In my statement today, I gave you a range. At the bottom end of the range there is not a difference. In fact, the bottom end of the range shows that it does not cost more.

Senator HARKIN. Where is that in your prepared statement? I just must have missed it.

Mr. CROWLEY. Do you have the briefing statement?

Senator HARKIN. I see. Where is that?

Mr. CROWLEY. It is on page 11.

Reduced storage is $169 million to $253 million.

Senator HARKIN. Yes.

Mr. CROWLEY. That is a short-term savings. We believe that there will not be much more in terms of savings with regard to storage.

At the bottom end, it would make the certificates less expensive than cash. But at the top end there is a big difference. The difference is that net loan outlays are greatly increased. Our feeling is that the real net loan outlays are probably increased about 15 percent as a result of this program, which would be more than the reduced storage.

Senator HARKIN. You said the net increased loan outlays are about 15 percent.

Mr. CROWLEY. Yes, sir.

Senator HARKIN. Is that sort of an average, is that what you are saying?

Mr. CROWLEY. That is an average.

Senator HARKIN. A midpoint.

Mr. CROWLEY. Yes.

Senator HARKIN. So, it could be higher?

Mr. CROWLEY. It could be higher.

Senator HARKIN. Could it be lower?

Mr. CROWLEY. It could be lower.

Senator HARKIN. How long would it take before we could get a good handle on it? I mean, after all, have not most of the PIK certificates now expired?

Mr. CROWLEY. Most of them.

Senator HARKIN. How many?

Mr. CROWLEY. $3 billion of them have been used. You still have about $2.5 billion outstanding, and you——

Senator HARKIN. What is the expiration date?

Mr. CROWLEY. What is it? Eight months after the month in which issued——

Senator HARKIN. Nine months.

Mr. CROWLEY. Nine months. So it varies.

Senator HARKIN. Well, they are all going to be expiring sometime this year.

Mr. CROWLEY. Yes, sir.

Senator HARKIN. By summer, I guess, would they not? When was the last issuance of PIK certificates? Does anyone know?

Mr. CROWLEY. December—there may be more coming out soon, sir. Deficiency payments are coming due, for example.

Senator HARKIN. Well, are they still coming out with them?

Mr. CROWLEY. Yes, they are still coming out with them. Right now, Agriculture has approved something like $1.8 to about $3.2 billion more to come out this year. Also, there will be deficiency payments due coming out that could be another $5 billion. Some of that could be issued in certificates.

Senator HARKIN. Mr. Crowley, I think that this is rather startling. Given the budget constraints that we have and the fact that we are being asked to lower price supports by, in the 1985 farm bill, 2 percent next year, 3 percent the year after, and 5 percent the year after, the administration has come down and asked us to cut it by 10 percent per year over the next 3 years. Now we find out that the PIK program on an average may be costing us 15 percent more in loan outlays than if we had just a direct cash payment out there to farmers.

Is that the correct way of stating it, 15 percent more than if we had just paid cash?

Mr. CROWLEY. Remember, you have offsetting benefits to this, too.

Senator HARKIN. I am sorry?

Mr. CROWLEY. You have offsetting benefits to farmers and to grain companies. But yes, 15 percent is a good figure.

Senator HARKIN. Looking at the Government ledger side of it. You are right, there are offsetting benefits. Some farmers have benefits. Grain companies certainly have benefits to the PIK certificates.

The benefit to the farmer, I suppose, is what, storage?

Mr. CROWLEY. Storage.

Senator HARKIN. Cutting down on storage. Being able to market his grain anytime he wants after that. Getting the full benefit of the PIK certificates——

Mr. CROWLEY. Or in the case of wheat producers, for example, their certificates are not worth quite as much as corn producers.

The worth really is the difference between the PCP, the posted county price, and the loan rate. That difference is quite dramatic in corn. In wheat it is pretty close. So, wheat growers can benefit by selling their certificates to corn growers.

Senator HARKIN. Is that happening?

Mr. CROWLEY. I believe it is, yes, sir.

Senator HARKIN. Because they can exchange it for any commodity they have under this loan for CCC, right?

Mr. CROWLEY. Well, it is a commodity that CCC will make available. CCC puts out a catalog that details what commodities it will make available for this. And the only commodities so far that have been restricted have been honey and sugar. It can be used for any of the others. The briefing document there shows you on page 7 what the certificates have been used for, both in terms of CCC inventory and in producer loans, it gives you both the bushels and the value, for wheat, corn, sorghum, rye, oats, barley, and soybeans. Honey was allowed originally but then stopped. You cannot redeem them for honey anymore.

Senator HARKIN. I just want to follow up and then I will finish, Mr. Chairman, very shortly.

If there is an increase in cost to the Government of 15 percent, that would be substantial.

What was our loan outlays this last year? Do you know what the figure would be, total for loan outlays?

Mr. CROWLEY. It would not be 15 percent of total outlays. It would be 15 percent of total commodity certificate payments.

Senator BOSCHWITZ. The total outlays by the CCC——

Senator HARKIN. It did not increase the loan outlays by 15 percent.

Mr. CROWLEY. Not all loan outlays, no. What we say is that it only increases as a percentage of the PIK certificate use. Not all loans are made that are going to be redeemed with PIK certificates. Some loans are going to be made and they are going to be redeemed in cash or they are just going to be forfeited to CCC. Of the ones that are redeemed by certificates, those are going to cost you 15 percent more.

Senator HARKIN. Fifteen percent more than what?

Mr. CROWLEY. Than cash.

Senator HARKIN. I am trying to get a handle on what that translates into in dollar terms. What was the range on that? What would be the average then of 15 percent? You have 3.9 to 3 point——

Mr. CROWLEY. 3.6.

Senator HARKIN. 3.6.

Mr. CROWLEY. Right.

Senator HARKIN. So that 15 percent then would translate into how much money?

Mr. CROWLEY. About $450 million.

Senator HARKIN. About $450 million. And that has been in 1 year's period of time?

Mr. CROWLEY. Yes.

Now, storage would come off of that. Storage would come off of that.

Senator HARKIN. Storage does come off of that?

Mr. CROWLEY. Storage does come off of that in the short term, yes.

Senator HARKIN. I am still trying to get a handle on what this bottom line figure is. What would it be if you subtract storage off of that?

Mr. CROWLEY. Storage costs are between $169 million——

Senator HARKIN. And $253 million.

Mr. CROWLEY. And two——

Senator HARKIN. So, we could say at a minimum it would be about $200 million.

Mr. CROWLEY. Right.

Senator HARKIN. At a minimum, $200 million, for 1 year. That is not an insubstantial amount of money. Obviously, that increase, that could be a substantial amount of money for farm program costs.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Boschwitz.

Senator BOSCHWITZ. I am going to try to read Mr. Crowley's statement. Perhaps I could yield to Senator Bond, or do you want to go back to the other side?

The CHAIRMAN. Let us go back to Senator Conrad, who beat us all here today, and then Senator Bond.

I should point out that this is a complicated subject. I am very appreciative of the work that GAO has done on it. I know Senator Helms is, too, because he originally requested it. Because of that, I have already notified Mr. Crowley that there will probably be followup questions for the record. It is a difficult and complex subject, certainly for those of us who do not handle PIK problems on a day-to-day basis.

I also have a strong feeling that it changes considerably depending upon the year. Because of last year's storage problems, this year may be entirely different from last year as far as the application of PIK certificates is concerned.

Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

I also want to thank Mr. Crowley and his associates for the work that has gone into this. This is a difficult subject area.

The question that I want to try to get an answer to is whether or not there has been any analysis of the distribution of the benefit of the $3 billion that is out on the table so far, that is, the PIK certificates that have been cashed in. Let me give you a preface before you seek to answer that question, because I have had many people come to me and say: look, we had corporate jets flying from Texas to North Dakota to PIK and Roll. We had people coming out of Minnesota trucking corn to North Dakota because of the county differential. Correct me when you answer if I misstate what you have outlined in your study. Again I want to thank you for delving into this, because I know it is a thorny business. If you are not prepared to answer, I certainly can understand that as well.

If we have got $3 billion out there, have you had an opportunity to analyze the distribution of those benefits, again in line with the kinds of apocryphal statements or anecdotal statements that have been made to me, very serious questions such as, who has received the real benefit? Any analysis of that?

Mr. CROWLEY. No analysis, sir, but PIK and Roll, the PIK long-distance substitution problem was corrected by USDA back in October or September. If you do not consider that——

Senator CONRAD. I think October.

Mr. CROWLEY. Okay.

If you do not consider that, it is our feeling—not an analysis—but it is our feeling that farmers primarily benefit from the certificates, other than that situation.

Senator CONRAD. Believe me, this is a critical issue because I go on to the floor of the U.S. Senate, I have some of my good friends who are from more urban areas who come up to me and say: look, you know, we hear this horror story about some corporate jet flying from Texas with hundreds of thousands of dollars of PIK certificates. I mean, I have had people tell me that one wealthy farmer who is able to fly his own private plane back and forth to PIK and Roll made $400,000 or $500,000 last year. So, it goes beyond a question of grain companies versus farmers. It is also a question of which farmers benefit.

Has any analysis of that been done?

Mr. CROWLEY. Not——

Senator CONRAD. Or do you have any sense of where the benefit lies, even between farmers?

Mr. CROWLEY. No, I do not, sir. But as I told the chairman before, we do have a job that we are doing on the administration of the program, and we are trying to get a handle on that. Including the job we're discussing here today we have two jobs going. We are looking at the effect of the PIK and Roll. We are trying to get a handle on who did benefit and how much, on that particular instance. But we are also——

Senator CONRAD. I am a long-distance PIK and Roll, because there is a case where I have been told of a specific corporation that made millions with long-distance PIK and Roll. I would like to in private session just pass that on to you so maybe that could be added to your analysis.

I have also been told repeatedly that there were farmers who are big farmers, wealthy farmers who are able to be moving themselves between just parts of my State. They would go from eastern North Dakota to western North Dakota and PIK and make lots of money.

Is that being analyzed currently?

Mr. CROWLEY. We are looking into the administration of the program at the local level, and that would be included, yes, sir.

Senator CONRAD. All right. That is something that would be of great interest to me and, I think, of great interest, Mr. Chairman, if I might, great interest to all of us and to the committee, to have an analysis of the distribution of the benefit. There are an awful lot of farmers out there who do not feel that they received much benefit out of this thing and awfully big dollars moving through the program.

The CHAIRMAN. Dollars so big that PIK certificates are even becoming an area of counterfeiting. In fact, in one case I believe $900,000 or more of counterfeit PIK certificates were recovered. Many people see this as a new kind of cash.

I am not convinced that any one has thought this through carefully. The Senator from North Dakota raises a valid point. We need to know cost projections and usage variations for the coming year. We need to know where they go and who gets the benefits.

The Senator from Missouri.

Senator BOND. Thank you, Mr. Chairman.

I certainly appreciate what Mr. Crowley has presented to us today. I am reminded of the old saying that in these complex and chaotic times if you are not totally confused you are just not thinking clearly. That suggests to me that my confusion may have some redeeming virtues.

I would like to ask Mr. Crowley——

The CHAIRMAN. You are joined in it by the chairman, I want you to know.

Senator BOND. I do have some questions that perhaps may help me a little bit. Mr. Crowley, the Department of Agriculture should not get all the credit or blame for the generic certificates. As I recall, Congress has mandated these certificate payments for several programs. Could you refresh our memories on what those programs were? Is that information included in the report?

Mr. CROWLEY. I am not sure that I have the information on which ones were mandated and which ones the Secretary could decide. The programs included the Export Enhancement Program, the Deficiency Payment Program, the diversion payment programs, the ethanol certificates, export enhancement I said, export assistance program, conservation reserve programs, emergency feed programs, some disaster programs——

Senator BOND. All those were mandated?

Mr. CROWLEY. I cannot tell you whether they were mandated or not. We are not sure about whether they are mandated or left to the discretion of the Secretary.

Senator BOND. Let me move on to the second question. We have talked about grain producers, grain traders. But one area that I was interested in is, what kind of impact did these certificates have on livestock, dairy, and poultry producers? You mentioned one farmer in Fowler County, but did the animal sector derive any benefit from the certificate program? If so, what were those benefits?

Mr. CROWLEY. It should help the animal sector. This is just off the top of my head, but if corn prices go down, it should help the feed sector.

That is the best I can do for you right now, sir.

Senator BOND. The certificates allow loans which might have been forfeited to the CCC to be repaid. Do you have an idea without the certificates how many of the 1985 crop loans would have been forfeited to the CCC?

Mr. CROWLEY. Not offhand, no, sir.

Mr. WOOD. I would just point out, if I could, Senator, that in our computation of storage savings we made the assumption that all of the 1985 crops that were redeemed with certificates would have been forfeited.

Senator BOND. So, that was the underlying assumption of the report.

Mr. CROWLEY. Yes.

Senator BOND. Thank you.

I believe in the report, somewhere, it said the effect of certificates on net lending outlays cannot be directly measured. Different assumptions yield different estimates. I have heard that the ASCS may or may not agree with that. Can you enlighten me on what their view is, of what their response is to that?

Mr. CHERLOW. I believe that they will be here to speak for themselves, but let me just say that one of the key factors that would influence this cost estimate is the average posted county price at which the certificates have been exchanged. One of the reasons that we present a range rather than a specific number is because there are no data at present that accurately say what the posted county price has been on average for certificate redemptions. Therefore, we use a range for both corn and for wheat and then take an average based on the share of the certificates that have been used to settle corn loans versus wheat loans.

Senator BOND. All right. Finally, on the basis of your study and if the certificate program is continued, do you have any recommendations for changes in the program that would make it more cost effective?

Mr. CROWLEY. Not at this point, sir.

Senator BOND. I note the absence of a quorum.

Senator DASCHLE. There have been a lot of criticisms that the certificate program has almost become as much of a nonfarmer trading program as a farmer trading program. To what degree is that criticism valid?

Mr. CROWLEY. I have not heard that, sir.

Senator DASCHLE. You have not heard any criticism about traders actually receiving more benefits?

Mr. CROWLEY. Oh, I have heard particularly with regard to long-distance PIK and Roll, yes.

Senator DASCHLE. In your opinion, how valid is that criticism?

Mr. CROWLEY. I would have to give you my own personal opinion.

Senator DASCHLE. That is what I would like.

Mr. CROWLEY. I think it is valid.

Senator DASCHLE. You do think it is valid.

Mr. CROWLEY. Yes.

Senator DASCHLE. Could you elaborate a little bit more on why the validity of the criticism?

Mr. CROWLEY. Well, I think I had seen enough and read enough about long distance PIK and Roll. Without doing any detailed work on it, that was my personal opinion of it, which you asked for.

Senator DASCHLE. So, because of the long-distance PIK and Roll opportunities, the traders have done better. In terms of overall value, would you say that in monetary compensation that could be quantified?

Mr. CROWLEY. We are trying to get a handle on what the PIK and Roll costs were and who benefited from it. Other than PIK and Roll, I made the comment before that it was our feeling when we did this job that it is primarily farmers who are benefiting from the certificates. But that is other than the PIK and Roll problem, PIK and long distance Roll.

Senator DASCHLE. In a related question, as you analyzed this system, how subject to fraud and abuse do you think the certificate

program is? Is it fraud- and abuse-free at this point? Is it invulnerable to efforts at fraud and abuse?

Mr. CROWLEY. I do not think anything is invulnerable to fraud and abuse.

Senator DASCHLE. Did you see any indication of it as you analyzed the program to date?

Mr. CROWLEY. No, sir, we have not. Our analysis to date was to look primarily at the costs of the program from a very macro look. We have not been out to the individual counties yet, and that is where you would really find that sort of thing, sir.

We are looking into the administration of the program down at the local level. We have to get out there to find that kind of thing.

Senator DASCHLE. So, what you are saying is, while you have looked at it from a macroeconomic point of view, it is too early to tell whether there is any degree of what we would call fraud or abuse in the program at this point?

Mr. CROWLEY. Yes.

Senator DASCHLE. Let me go back to the actual trading. As I understand it, the certificates are based on the loan at the county level. Is that correct?

Mr. CROWLEY. The value of the certificate is the posted county price at the county level.

Senator DASCHLE. Which is based upon the loan rate.

Mr. CROWLEY. No. It is based upon the market value.

Senator DASCHLE. The market value.

Why within a certain area where you have a situation where the loan rates were the same in two counties, two adjoining counties and you have a difference of a certain amount in the certificate price, would you consider that abnormal or not?

Mr. CROWLEY. Not necessarily. You could have a different posted county price in the two different counties. The posted county price is based upon a market value in the counties.

Senator DASCHLE. Did you see that that had happened to any frequency as you analyzed the program?

Mr. WOOD. We really did not look in any detail across the country at PCP's. I do know that the Department has made some changes in December and January. They started basing each county off of two terminal markets instead of one. We understand that they have gone through and in cases where, as you alluded to, there are adjacent counties that appear to have greatly different PCP's, they have tried to adjust for that. But we really do not have any real data. We did not do a survey of that.

Senator DASCHLE. One last question: in discussing this with a few people, the comment was made that this certificate, the generic certificate program has a tendency to undermine the traditional economics of nonrecourse loan programs, that it eliminates the price supporting feature of a nonrecourse loan. Would you agree with that?

Mr. CROWLEY. Yes, sir.

Senator DASCHLE. To what degree?

Mr. CROWLEY. The purpose of a nonrecourse loan, of course, is to take commodities off the market. When you use PIK certificates, you are in effect bringing those commodities on to the market. So, the more commodities that you have on the market, the lower the

market price; and the lower the PCP, the higher the Government costs are going to be.

Senator DASCHLE. Thank you, gentlemen.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Boschwitz.

Senator BOSCHWITZ. I see that there is a farmer who is going to testify a little later, James Moseley, who points out how it helped the young farmer to get into business by using the PIK and Roll. I have been, by and large, favorably impressed with the PIK certificates. I think that they have been quite helpful.

It is not clear to me why there is this additional cost. I apologize for not being here at the time of your testimony. I have read your prepared statement, and it is still not clear to me why it should be an additional cost. You say, first of all, that when the certificates are exchanged for commodity outlays, the CCC price support loans ultimately rise. We estimate this rise in loan outlays will exceed the reduction achieved by issuing certificates.

I did not quite understand, "we estimate this rise in loan outlays will exceed the reduction." Reduction of what?

Mr. CROWLEY. Senator, do me a favor before we go on from here. I have a document in your folder there. It is called a briefing on this. I included some examples in there to show you how it is increased. Let me refer you to a couple of pages.

Senator BOSCHWITZ. Yes. Which page?

Mr. CROWLEY. Go to page 9.

I was making the point before that outlays are increased two ways: directly and indirectly. The example 2.1 there shows how the outlays are increased directly. I read it before.

Senator BOSCHWITZ. In other words, the price is lower than the loan, and the PIK certificate is used for the purpose of redeeming the corn at the posted county price.

Mr. CROWLEY. That is right.

Senator BOSCHWITZ. But I do not understand. You say that more people will then take out loans. What is the percentage of farmers who are in the program?

Mr. CROWLEY. It is very high.

Senator BOSCHWITZ. You have got to know.

The CHAIRMAN. It is bigger than a bread basket and higher than——

Senator BOSCHWITZ. Well, you have to know. You say that more loans are going to be taken out.

Mr. CROWLEY. Yes, but the potential for how many loans is not—I do not think it is that great, is it?

Mr. WOOD. I guess I should say it is not only the number of loans, it is really the total quantity that we are talking about that is put under loan. In terms of participation, I think about somewhere in the neighborhood of 90 percent of the base acres of corn are eligible for loans and deficiency payments. But I do not know what the historic percentage has been of people who actually take out loans, what percentage of that results in actually loans being made.

Senator BOSCHWITZ. Let us presume that a guy has got a bunch of dairy cows and he is raising some corn. He would normally feed

it. He takes out the loan. Then he uses a PIK and Roll and buys the loan. The loan is $1.84 or whatever.

Mr. CROWLEY. Senator, that is exactly the example I have here, which is a dairy farmer who normally would not——

Senator BOSCHWITZ. So he buys it back at $1.50.

Mr. CROWLEY. Right.

Senator BOSCHWITZ. Where is the cost?

Mr. CROWLEY. The cost is that, if you had paid cash, if you paid the man cash for the diversion or whatever you paid him money for, he would have gotten $1,500 in cash. In this way what he did——

Senator BOSCHWITZ. Wait a second. Where does the $1,500 come in?

Mr. CROWLEY. Let me go back to my example.

Senator BOSCHWITZ. Why is the 34 cents an increase in cost? I mean, the fact that he took out the loan, used PIK and Roll and maybe did this the same day or the same week. I do not understand where the increase in cost comes in.

Mr. CROWLEY. The increase in cost comes from what you avoided in terms of a cash outlay. You avoided a cash outlay of $1,500, but it cost you $1,840 to avoid that.

Senator BOSCHWITZ. Oh, it is 100 bushels, in other words, 1,000 bushels, I should say. And you made him a loan of $1,840——

Mr. CROWLEY. Right.

Senator BOSCHWITZ [continuing]. And he redeemed it for $1,500, so it cost $340.

Mr. CROWLEY. Right.

Senator BOSCHWITZ. That is an increase in outlays?

Mr. CROWLEY. Yes, sir.

Senator BOSCHWITZ. Why is it an increase in outlays? You have PIK certificates.

Mr. CROWLEY. Your increase is cash money that you paid to the farmer of $1,840.

Senator BOSCHWITZ. Yes.

Mr. CROWLEY. You would have normally paid the man only $1,500 in the cash payment.

Senator BOSCHWITZ. In what cash payment?

Mr. CROWLEY. He got the certificate either through buying it——

Senator BOSCHWITZ. Yes, that is right.

Mr. CROWLEY [continuing]. Or because he was eligible for another program.

Senator BOSCHWITZ. Yes. He got it as a deficiency payment.

Mr. CROWLEY. Okay.

Senator BOSCHWITZ. You cannot say the 34 cents is an increase in the cost simply because he would have gotten that in cash for a deficiency payment.

Mr. CROWLEY. But it is an increase in net loan outlays, if the man would not have been in the USDA loan program other than for the certificate——

Senator BOSCHWITZ. Oh, so you say the 34 cents is an added cost?

Mr. CROWLEY. Yes. It is an added net loan outlay.

Senator BOSCHWITZ. Added net loan outlay——

Mr. CROWLEY. Excuse me——

Senator BOSCHWITZ. However——

Mr. CROWLEY. The whole $1,840 is an added net loan outlay.

Senator BOSCHWITZ. But $1,500 is repaid. So, $340 is what we are dealing with.

Mr. CROWLEY. $1,840 is the net loan outlay. What you avoided was a cash payment in another program of $1,500.

Senator BOSCHWITZ. But $1,500 is to be paid because $1.50 is the posted county price, is that right?

Mr. CROWLEY. Right.

Senator BOSCHWITZ. So, $340 is what we are dealing with. And the $340 would be paid out as a deficiency payment.

Mr. CROWLEY. Pardon?

Senator BOSCHWITZ. The $340, the certificates that——

Mr. CROWLEY. No, it would not be paid out as a deficiency——

Senator BOSCHWITZ. It would have.

Mr. CROWLEY. No.

Senator BOSCHWITZ. That is how we got the PIK certificates in the first place.

Mr. CROWLEY. No. The $340——

Senator BOSCHWITZ. Instead of getting cash in the deficiency payments, he would have received.

Mr. CROWLEY. No, no, no. Deficiency payments are the difference between the target price and the loan rate. The loan rate is $1.84.

Senator BOSCHWITZ. I understand. So, you got $1.19, and a certain portion of that was in PIK certificates, right?

Mr. CROWLEY. He got PIK certificates either for a diversion payment or for a PIK payment.

Excuse me. Diversion payment or a deficiency payment.

Senator BOSCHWITZ. Yes, that is right.

Mr. CROWLEY. $1,500. Normally, we would have given that to him in cash.

Senator BOSCHWITZ. That is correct. But you did not.

Mr. CROWLEY. Right.

Senator BOSCHWITZ. So there was no cash outlay.

Mr. CROWLEY. That is right.

Senator BOSCHWITZ. As you point out in your testimony.

Mr. CROWLEY. That is no cash outlay for that, but there is a cash outlay, when you give him a loan of $1,840.

Senator BOSCHWITZ. There is a cash outlay of $1,840.

Mr. CROWLEY. Right.

Senator BOSCHWITZ. We are talking about how PIK certificates increase outlays, so in order to use the PIK certificates, he is going to have to redeem the loan of $1,500.

Mr. CROWLEY. The $1,500 is not treated as a receipt.

Senator BOSCHWITZ. When he redeems—certainly it is.

Mr. CROWLEY. No, it is not a receipt.

Senator BOSCHWITZ. He gets $1,840 in a loan.

Mr. CROWLEY. Yes, sir.

Senator BOSCHWITZ. So, now he goes and pays the county posted price.

Mr. CROWLEY. With the certificate.

Senator BOSCHWITZ. With the certificates. So, the 34 cents therefore does become an outlay. The certificates are used to pay the $1.50.

Mr. CROWLEY. Yes.

Senator BOSCHWITZ. That is the explanation.

The reconcentration costs, the idea of not having to be in and out of the elevator, and the transportation costs, as you state in here, does equal the 34 cents, in effect. Is that correct?

Mr. CROWLEY. That is right.

Senator BOSCHWITZ. But you also say in here that you are unable to measure that very well.

Mr. CROWLEY. Unable to measure it precisely. That precisely may be left off there. I cannot measure it exactly.

Senator BOSCHWITZ. You also say that the certificates may have helped ease the Corn Belt's storage crunch.

Mr. CROWLEY. Yes.

Senator BOSCHWITZ. Because commercial storage in the Corn Belt was limited at the time CCC may have transported forfeited corn to other parts of the country where storage was available. However, it is difficult to estimate just how much transportation would have occurred. It is difficult to quantify the savings.

Does that mean that you did not?

Mr. CROWLEY. We could not, no.

Senator BOSCHWITZ. You did not quantify the savings?

Mr. CROWLEY. No, sir.

Senator BOSCHWITZ. In coming up with your analysis, you did not make an estimate as to what savings would have occurred?

Mr. CROWLEY. That is correct.

The Chairman. Do you understand it now?

Senator BOSCHWITZ. I sure do.

Mr. CROWLEY. As I pointed out in my testimony earlier, that was one of the benefits of the program.

Senator BOSCHWITZ. It is a benefit of a program. I read that part of your prepared statement as well. But that was a great savings. In the discussion paper that I received—and I do not know from whom—it said that the reconcentration costs could have run well into excess of $750 million. Of course, when you consider the 8 cents or so in and out, 10 cents in and out, and the storage and transportation charges, it could be very substantial.

Future storage costs will be reduced only if in the long run certificates ultimately reduce CCC-owned inventory.

Mr. CROWLEY. Yes, sir.

Senator BOSCHWITZ. Did you make an estimate of how much additional corn was consumed or sold because of the lower price?

Mr. CROWLEY. We estimated that of the certificates redeemed, probably there could be a 10 percent decrease in CCC inventory.

Senator BOSCHWITZ. A 10 percent decrease in CCC inventory was used as a reduction of the costs in figuring out the——

Mr. CROWLEY. No, we looked at short term.

Senator BOSCHWITZ. Pardon me?

Mr. CROWLEY. We were looking at the short-term costs. We used 10 percent. I do not think that would be very high.

Senator BOSCHWITZ. There would be a 10 percent reduction in CCC inventory.

Mr. CROWLEY. No, not CCC inventory. It is of the commodities that are redeemed with the certificates.

Senator BOSCHWITZ. CCC's future storage costs will be reduced only if in the long run certificates ultimately reduce CCC-owned inventory.

Mr. CROWLEY. Yes, sir.

Senator BOSCHWITZ. And you said that you felt that CCC-owned inventory would be reduced by 10 percent.

Mr. CROWLEY. No, sir, I did not.

Senator BOSCHWITZ. Pardon me, I misunderstood.

Mr. CROWLEY. I said, of the commodities that are redeemed from CCC inventory, there would be a 10 percent reduction.

Senator BOSCHWITZ. How much——

Mr. CROWLEY. If certificates took out 100 bushels from CCC inventory, what I am telling you is that probably about 90 would go back in.

Senator BOSCHWITZ. How much additional demand do you think there was because of the use of PIK certificates in lowering market price?

Mr. CROWLEY. We were not able to isolate that because of too many factors that affect demand. It is our feeling that it did have an impact on at least the domestic consumption of corn.

Senator BOSCHWITZ. I would think so. There seems to be some evidence that there has been an increase in exports as well. Did you consider this?

Mr. CROWLEY. Yes, we did. In fact, my statement said that we anticipated an increase in exports. I am not sure that it——

Senator BOSCHWITZ. You said there is a 15 percent difference, that PIK certificates cost 15 cents more than a dollar of making a payment.

Mr. CROWLEY. Yes, sir.

Senator BOSCHWITZ. Did you or did you not consider the increase in shipments, the increase in exports, or the increase in consumption in lowering the 15? Did that have any effect on your calculations?

Mr. CROWLEY. Let me turn that over to my colleague.

Mr. CHERLOW. Senator, let me try to help you out. The estimate——

Senator BOSCHWITZ. That is nice of you. I will try to help you out sometime, Mr. Cherlow.

The CHAIRMAN. You may want to carefully consider your next choice of words, Mr. Cherlow, but go ahead with your answer.

Mr. CHERLOW. The estimate that we had first looked at is the effect on net loan outlays relative to the reduction in the cash payments for which the certificates were substituted; we then considered storage costs. In estimating the change in storage costs, we did not precisely estimate a change in demand. However, we used assumptions about how demand responds to changes in price that are consistent with what many agricultural economists believe in making our estimate of what would happen to inventories in the long run. And that was the basis for Mr. Crowley's statement that in the long run the inventories probably will not decline a lot. It might be as much as 10 percent of the number of bushels that are redeemed with the certificates.

So, we have two sets of numbers: one on the loan outlay increase, one on the storage savings. Both of those are presented as ranges.

There is a lot of uncertainty in these estimates. We do not know precisely where one would fall in that range, if one would fall in the middle or the high or the low end.

Senator BOSCHWITZ. I did not understand your entire answer because I did not think it was very responsive, even though you did indeed attempt to help me out. Let me be rather specific. In figuring that PIK certificates cost 15 cents more than cash, did you come to the conclusion that there was more demand and that that demand had any impact on the 15-cent differential?

Mr. CHERLOW. Yes, there was more demand, and that does have an impact on the estimate.

Senator BOSCHWITZ. In other words, without that demand, the 15 cents might have been 18 or 20 cents.

Mr. CHERLOW. That is correct.

Senator BOSCHWITZ. So that you did consider that?

Mr. CHERLOW. Yes.

Senator BOSCHWITZ. If I may ask one more question, Mr. Chairman, maybe even go to a second round.

There is also a question of quality loss, of course, that may or may not have been considered. In the absence of this program, CCC would have had to transport approximately 900 million bushels of grain from areas with acute shortage of storage, mostly in the Midwest to regions where storage was available, primarily in the Southeast. If the elevators in and out charges are added to the transportation costs, the total price tag for reconcentration could have run well in excess of $750 million, a big number. Did you not conclude that such a number existed? Do you disagree with that statement?

Mr. CROWLEY. It sounds very high. I would like to take a look at the calculation that supported it.

Senator BOSCHWITZ. 900 million bushels, 10 cents in and out, storage and transportation.

Well, Mr. Chairman, I may want to ask some more questions, but perhaps we will do it for the record.

The CHAIRMAN. Thank you. I appreciate it. We do have a number of other witnesses to go through before 4 o'clock. I know a number of other Senators will want to submit questions for the record. If that is not satisfactory, I would be happy to invite this panel back.

Senator BOSCHWITZ. I thought that the policy aspects of the PIK certificates were so positive and that if markets are important, you know, have the impact of marketing loan, I think it would help.

I am sorry to ask so many questions.

The CHAIRMAN. No, I think those are very good and important questions. Most people do not understand the PIK program, and we are constantly asked how can we justify such enormous costs. That is one of the reasons I wanted this hearing, so we could get some answers.

Thank you very much, gentlemen. You have all been very helpful, and I appreciate having you here.

[The following written questions from the committee and GAO's answers thereto were received for the record:]

Question 1. The Congressional Budget Office has estimated that requiring current loans to be paid off at the loan rate, rather than the posted county price, would

reduce outlays by $1.4 billion over 5 years. Do you agree with this estimate? What are the implications, aside from costs or savings, of such a modification?

Answer. The CBO estimate is based on its assumptions of certificate issuances and redemptions and market conditions prevailing over a 5-year period (fiscal years 1988 through 1992). CBO used these assumptions to estimate certificates' effects on net CCC outlays for each fiscal year under the current redemption policy (exchanging certificates at the market price, or PCP). Using these "baseline" estimates, CBO then estimated how the outlay effects would change if the certificates were required to be exchanged at current loan rates rather than market prices. The net effect was an estimated $1.4 billion reduction in net CCC outlays, over the 5-year period, from the baseline estimates.

Although it is impossible to predict the effects with certainty, the CBO estimates are within the range we consider reasonable for budget forecasting purposes. CBO's estimate of the outlays effects per dollar of certificates redeemed—generally, about a 15 percent increase over strictly cash payments under current market conditions—is within the range we reported to be most likely for the current year. Although we did not estimate these outlay effects for future years, we note that CBO's estimates of the future effects are based on the same factors (particularly the average loan-rate-to-PCP ratio) that we used to estimate current-year effects.

The outlay reduction achieved by this modification, compared to the current practice, depends largely on the dollar amount of certificates that are assumed to be issued over the 5-year period. The greater the assumed value of certificates issued, the greater the estimated outlays and, thus, the greater the savings from modifying the redemption policy. Savings would also depend on the extent to which market prices remained below crop loan rates.

There are a number of implications of the proposed modification. If certificate exchange values are set equal to the rates at which commodities were placed under loan, farmers would have little incentive to use certificates to settle loans. Certificates would not enable farmers to obtain additional profit from the nonrecourse loan program. There would be little incentive to use certificates for one crop versus another, and many of the certificates would likely be returned to CCC for cash reimbursement.

In summary, the implications of this policy include: (1) certificates would probably be of less value to farmers; (2) certificates would also be of less value to grain companies, both as marketing tools and as mechanisms for obtaining CCC-owned inventories; and (3) premiums would likely decline, reflecting certificates' diminished values.

Question 2. Is any portion of the proceeds from a generic certificate transaction counted against a producer's $250,000 payment limitation? Specifically, could the use of certificates allow some producers to receive a net benefit above the limit set by Congress?

Answer. In part because certificates are negotiable instruments, their use can provide some producers with net benefits above the limit set by the Congress. For example, profits derived from selling certificates at premiums or using certificates to "Quick PIK" (i.e., take out a price-support loan and immediately redeem it with certificates, thereby saving storage costs) do not count against the payment limitation.

It is important to note that it is only the proceeds from certificate transactions that are not subject to payment limits, not the certificates themselves. The portion of a deficiency or diversion payment to a producer made in certificates (in lieu of cash) does count against the $50,000 payment limitation on regular deficiency and diversion payments.

ASCS's October 29, 1986, notice (PA-1097) to state and county offices states that gains obtained by repaying a loan at a lower level than the original loan level for a crop of upland cotton, rice, or honey (such as, for example, marketing loans) by any means other than certificates are subject to the $250,000 payment limitation. Our Office of General Counsel is currently reviewing pertinent legislation and other relevant material to determine whether gains obtained by repaying marketing loans with certificates should properly count against payment limitations.

The CHAIRMAN. We have Secretary Amstutz here, accompanied by Ralph Klopfenstein, Deputy Administrator of ASCS, and William Bailey, Deputy Administrator for Program Planning of ASCS.

Mr. Secretary, welcome to a room very familiar to you. I understand you are here to tell us what the Department's objectives were in setting up this program. Have you achieved them? Do you consider it a success? What are your objectives in 1987?

Senator BOSCHWITZ. How much time are you going to give him, Mr. Chairman?

The CHAIRMAN. The panel has 15 minutes. They can divide it any way they want.

STATEMENT OF DANIEL G. AMSTUTZ, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS AND COMMODITY PROGRAMS, U.S. DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY RALPH D. KLOPFENSTEIN, DEPUTY ADMINISTRATOR, COMMODITY OPERATIONS, ASCS, AND WILLIAM F. BAILEY, DEPUTY ADMINISTRATOR, PROGRAM PLANNING AND DEVELOPMENT, ASCS

Mr. AMSTUTZ. Thank you. Mr. Chairman and members of the committee, my colleagues and I appreciate the opportunity to appear before you today to discuss the Commodity Credit Corporation's (CCC) use of commodity certificates as payments under various programs.

Today, Mr. Chairman, I will confine my remarks to a description of the manner in which commodity certificates are issued and the goals and objectives that are being accomplished through the use of certificates. The use of certificates in various programs has resulted in accomplishing a number of goals and objectives consistent with the Food Security Act of 1985. The decision to use commodity certificates was based upon the flexibility provided to program participants and the benefits to CCC and the American taxpayer.

Commodity certificates are issued in a monetary amount and may be transferred to other persons. Some certificates may be exchanged for only specific commodities. Others are referred to as "generic" certificates, since they may be exchanged for more than one kind of commodity in CCC inventory. A holder of a certificate may acquire commodities owned by CCC in a quantity that is equal in value to the amount of the certificate. CCC determines the kinds of commodities which may be acquired and periodically issues a catalog listing the location and quantity of commodities that are available. In addition, producers who have outstanding CCC price support and farmer-owned reserve loans may acquire the commodities which have been pledged as collateral for such loans by exchanging the certificate with CCC. In this transaction, the producer redeems the loan collateral, and CCC purchases the commodity at the redemption price and thereby becomes the owner of the commodity. CCC will then accept the certificate from the producer and exchange a quantity of the commodity that is equal in value to the amount of the certificate. The value of the commodity redeemed with certificates is determined by CCC based upon prevailing market prices.

BENEFITS OF CERTIFICATE USE

Certificates are popular with producers and provide benefits to producers in several ways. Because of their generic and transferable features, a secondary market soon developed in certificates. Certificates have been trading, from the inception, at premiums over face value, ranging from 3 to 35 percent. The premium on certificates in no way adds to the cost of the program but is an added

benefit to producers who are more often sellers of certificates rather than buyers.

Producers who retain certificates for use in acquiring commodities which had been pledged as collateral for price support loans benefit in several ways. Producers can, and often do, obtain their loan and then repay it immediately in order to acquire the commodity. This feature allows producers to receive the price support and income protection provided by a combination of the price support rate and deficiency payments. Consequently, a producer can obtain the price protection afforded by the loan while still being able to have access to the commodities for on-farm use at the market price, or to make orderly marketing decisions to redeem the loan collateral and sell the commodities. There is a clear incentive provided for the producer to utilize this feature which some have referred to as PIK and Roll because producers may acquire commodities at market prices which are lower than the price support rate, and they may also avoid the cost of storage in whole, or in part.

The use of certificates has also helped domestic commodity-related industries by ensuring that a continuous flow of free commodity stocks are, or can be, available at market prices. This feature allows domestic commodity prices to react to world market prices. Thus, the producer obtains income protection while at the same time commodity prices may move below loan levels.

An important benefit to CCC, in addition to helping foster the market-oriented concept of our farm programs, is the cost-saving feature associated with the use of certificates. While it is recognized that the use of certificates may result in additional loan activity, their use in acquiring commodities which had been pledged as loan collateral that would otherwise have been forfeited to the Government has resulted in substantial savings in storage, handling, and transportation costs.

Further, the use of certificates was of great assistance to CCC in the summer and fall of 1986 in resolving what was anticipated to be a tight storage situation. Certificates gave producers and grain warehousemen the opportunity to solve their own storage and marketing problems. It is estimated that more than 800 million bushels of grain were removed from the overall storage demand through the use of certificates. Grain was permitted to move into normal marketing channels at the decision of producers, at the decision of farmers, rather than as determined by the CCC.

Overall, of course, the use of certificates does not create additional storage space. It is a method whereby producers and grain warehousemen can solve their own problems, thereby collectively helping to meet storage demand. The problem is solved by market driven forces in a much more efficient way than if the entire problem were dependent upon a massive and expensive CCC shipping and reconstruction program. In other words, Mr. Chairman, the use of certificates permits grain and oilseeds to flow from areas of low price and tight storage availability to areas of greater storage availability and higher price.

An additional, but unintended, benefit to certificate holders occurred initially from a combination of the loan program substitution feature and the producer's use of commodity certificates to ac-

quire producer's loan collateral. The loan substitution provisions, which have been in effect for a number of years, allow producers who are in areas of limited storage to substitute their loan collateral for similar commodities in other areas where adequate storage space is available. It was not anticipated that this provision would be used in combination with certificates to acquire a producer's loan collateral, but it was.

The use of these features in combination, while helping to increase storage space availability, did cause market dislocations. These dislocations and the resulting unwarranted certificate premiums were particularly evident from longer distance substitutions. As soon as we were able to complete an analysis of this problem after it began this past fall, we decided to no longer allow producers the option to substitute loan collateral and use certificates to acquire that substituted collateral. Each feature can be used independently, but no longer together. Since this decision, this particular problem has been resolved.

Certificate Authorization and Issuance to Date

Certificates have been issued, and additional certificates have been authorized to be issued, as payments under the acreage reduction and land diversion, disaster assistance, conservation reserve, and emergency feed programs. They are also being used for payment to exporters participating in the Export Enhancement Program and the Targeted Export Assistance Program.

From April 30, 1986, until the present, CCC has authorized the issuance of certificates in the amount of some $8 billion. Those authorizations and the timing of certificate issuances are summarized as follows:

Generic Certificate Authorizations to Date

[In millions]

Program:	*Estimated certificate value*
1986 Advance Deficiency	$2,200
1986 Land Diversion	350
1986 Final Deficiency Payments (Wheat, Barley and Oats)	1,200
Conservation Reserve Program	86
Ethanol Certificate Program	54
Export Enhancement Program (EEP)	400
Targeted Export Assistance Program	100
Rice Marketing Certificate (1986 Crop)	5–25
Emergency Feed Cost-Share Program	5–15
Disaster Program	400
1987 Advance Deficiency	2,100–2,500
1987 Advance Diversion	500–600
1987 CRP (Corn) Bonus	340
Total	7,740–8,270

Timing of Generic Certificate Issuances

Program	*Dates*
1986 Advance Deficiency	Completed.
1986 Land Diversion	Do.
Ethanol Certificates	Do.
Conservation Reserve Program	Do.

Timing of Generic Certificate Issuances—Continued

Program	*Dates*
1986 Final Deficiency Payments (Wheat, Barley and Oats).	Completed.
EEP	Present to Sept. 30, 1987.
TEA Program	Do.
Rice Marketing Certificate	Present to Dec. 31, 1987.
Emergency Feed Program	Present to Mar. 31, 1987.
Disaster Program	Feb. 1, 1987 to Mar. 31, 1987.
1987 CRP (Corn) Bonus	Mar. 15, 1987 to May 15, 1987.
1987 Advance Deficiency [1]	Nov. 17, 1986 to Apr. 30, 1987.
1987 Advance Diversion [1]	Do.

[1] It is estimated that 10–15 percent of 1987 advance payments were made prior to Jan. 1, 1987.

As of March 11, 1987, a total of $3 billion in certificates have been used to acquire commodities that had been pledged as collateral for price support loans, and $429 million in certificates have been exchanged for other commodities in CCC inventory. This exchange data is summarized as follows:

SUMMARY OF GENERIC CERTIFICATE EXCHANGES FOR CCC INVENTORY AND PRODUCER LOANS AS OF MAR. 11, 1987

Commodities	Other commodities in CCC inventory	Commodities which had been pledged as price support loan collateral [1]	Total
Wheat:			
Bushels	53,823,092	210,602,617	264,425,709
Value	$128,086,634	[2] $501,186,003	[2] $629,272,637
Corn:			
Bushels	81,057,895	1,387,371,915	1,468,429,810
Value	$132,076,253	[2] $2,260,592,679	[2] $2,392,668,932
Grain sorghum:			
Bushels	25,569,069	76,674,498	102,243,567
Value	$45,563,845	[2] $136,633,248	[2] $182,197,093
Rye:			
Bushels	2,235,013	1,932,368	4,167,381
Value	$3,166,336	[2] $2,737,580	[2] $5,903,916
Oats:			
Bushels	359,107	1,285,823	1,644,930
Value	$369,010	[2] $1,321,282	[2] $1,690,292
Barley:			
Bushels	26,775,744	71,106,748	97,882,492
Value	$32,984,364	[2] $87,594,610	[2] $120,578,974
Soybeans:			
Bushels	482,881	2,585,203	3,068,084
Value	$2,444,428	[2] $13,086,749	[2] $15,531,177
Rough rice:			
Cwt	25,378,676	18,411	25,397,087
Value	$84,005,703	[2] $60,942	[2] $84,066,645
Upland cotton:			
Bales		4,637,749	4,637,749
Value		([3])	([3])
Honey:			
100 lbs		1,799	1,799
Value		([3])	([3])
Total certificate value	$428,696,573	$3,003,213,093	$3,431,909,666

[1] Reflects certificate exchanges processed through date shown on report—data may be lagged 2–3 weeks.

[2] Estimated certificate value based on the value per bushel for CCC inventory exchanged with certificates. Total estimated certificate value does not include upland cotton or honey.

[3] Not available.

Pricing of Commodities for Exchange for Certificates

For CCC to accomplish exchanges of certificates for CCC-owned commodities, market prices must be determined daily on all commodities and disseminated to some 10,000 locations in the United States. CCC implemented a differential pricing system last year for determining market prices in about 3,000 counties and 7,000 warehouse locations. The system is, of necessity, a uniform, nationwide system. The differential pricing system is based on the average difference between posted prices furnished to CCC by grain elevators on selected dates from January 1985 to January 1986 and market prices on those dates at major grain terminals where the elevators would normally transact business.

Despite the basic soundness of the differential pricing mechanism, there was a need last year for changes in the system so that we could more accurately value commodities. After careful study and much consultation, CCC made several changes in its pricing system which became effective last December 1. While staying with the basic differential mechanism, CCC now uses multimarket comparison pricing. This is consistent with normal commercial marketing practices. Grain elevators and the counties in which they are located are generally assigned two terminal markets which usually influence local markets at some point during the year.

Individual elevator differentials and county average differentials are established to each assigned terminal market. The higher value resulting when the respective differentials are applied to market values for the assigned terminals becomes CCC's certificate exchange value. This exchange value is usually referred to as the posted county price.

CCC's switch to the multimarket comparison pricing system has greatly helped our efforts to more accurately value grain in a manner that is as "on the market" as possible and is fair and equitable to both CCC and the producer. It remains one of our primary objectives in valuing commodities to determine a value as close to the local market price in any given area as possible, thereby letting the market decide where certificates will be used and for what commodity.

Mr. Chairman, let us now look more specifically at those areas where savings to the Government have resulted through the use of commodity certificates. Certificates issued during the summer of 1986 and exchanged for CCC inventory prior to October 1, 1986, allowed producers to acquire nearly 40 million bushels of wheat, 292 million bushels of corn, and about 40 million bushels of other feed grains which had been pledged as collateral for 1985 crop price support loans. These commodities would have otherwise been forfeited to CCC or placed in the farmer-owned reserve. Annual storage savings on this quantity of grain would range from $98 to $125 million. Savings in interest and handling charges would amount to another 20 to 25 cents per bushel with respect to this grain, or another $74 to $93 million.

Certificate exchanges from October 1, 1986 through March 11, 1987, have allowed 143 million bushels of 1985-crop wheat and feed grains, which had been pledged as loan collateral to be moved in market channels rather than being forfeited to CCC. Implied savings with respect to annual storage, interest, and handling—carrying charges—on this quantity are about $85 million.

The use of certificates permitted significant quantities—over 500 million bushels of 1985-crop grain collateral—to enter the marketplace at competitive levels. To date, about 250 million bushels which were listed in CCC's inventory catalog have been placed into the market through certificate exchanges. Although CCC's inventory of grain stocks today are nearly double that of a year ago, they would have been even greater without the use of certificates. Assuming without certificates that CCC inventory stocks would be 250 million bushels higher at this point, the annual costs of carrying this additional quantity would be about $150 million.

Without the use of certificates, essentially all of the 1985 crop which had been pledged as loan collateral would have been forfeited to CCC, and that quantity as well as the additional quantity of 250 million bushels listed in CCC's inventory catalog that was acquired by using certificates, would have remained in CCC's inventory and isolated from the marketplace. Accordingly, the use of certificates precluded the need, in total on what I just mentioned, precluded the need for $450 to $500 million in additional outlays for handling surplus grain last fall and storing hundreds of millions of bushels of wheat and feed grains.

From the standpoint of program cost, the biggest question surrounding the use of certificates concerns the issue of recycling. Recycling occurs whenever the net cost of the loan program is greater with certificates than without. It is evident that 1986-crop loan volume is greater than it would have been without the use of certificates. Also, the ultimate disposition of this grain will be different.

We are submitting for the record a table that shows the 1986-crop loans made to date, expected loan volume, and 1985-crop levels.

[The table follows:]

[In millions of bushels]

Commodity	1986 loan volume		1985 loan volume
	As of Mar. 11, 1987	Estimated volume	
Wheat	500.7	520.0	840.0
Corn	4,455.5	4,900.0	3,125.0
Sorghum	381.3	395.0	358.4
Barley	161.1	175.0	158.1
Oats	7.6	8.0	5.6
Total volume	5,506.2	5,998.0	4,487.1

Feed grain prices for the 1986-crop would likely have been below the price support levels even without the use of certificates. There-

fore, the increase in corn loan volume cannot solely be attributed to using certificates.

The recycling percentage for the 1986-crop is likely to be high. However, since the amount of certificates issued, or to be issued, are applicable to three crop years (1985 through 1987), the recycling effect should be assessed over that timeframe.

We have analyzed the effects of the use of certificates to date compared with a program in which no certificates would be issued for the 1986–88 fiscal years. Based on this analysis, we estimate that outlays associated with loans, with the issuance of $8.5 billion of certificates, for this period could be up to $550 million, higher, or equivalent to 7 percent of the total value of issued certificates.

This cost estimate of $550 million must be weighed against the short-run benefits that are occurring and the long-range implications. Immediate benefits include greater market liquidity, improved market price competitiveness, higher farm income, improved debt situation, and decreased carrying charges, especially pertaining to 1985-crop loans.

Previously in this testimony I gave some examples where the savings were between $450 and $500 million a year. I would submit that those are conservative estimates. I would submit to you that conservatively measuring the benefits on a quantitative basis and liberally estimating the costs, the net cost of this program is no higher than 1 percent of certificate value.

More importantly, certificates have and are serving as an integral part of our long-range market-oriented farm policy. With the use of certificates, a basic foundation has been established. Future advances can build upon this foundation. Although estimated increases in 1986–87 grain usage, both domestic and export, are not as high as earlier hoped, gains have been made. For example, estimated wheat use is up 170 million bushels from a year earlier. That is an increase of 8.7 percent. Estimated corn use is up more than 3 percent, or some 200 million bushels more than 1985–86 levels. We believe the results of using certificates have contributed significantly to the competitiveness of U.S. corn and U.S. wheat both domestically and internationally.

Mr. Chairman, the use of commodity certificates breaks the cycle of producer to CCC to market. It allows the producer's grain to go to market at the time, place, and price of the producer's choosing, rather than at the direction of CCC. It takes CCC out of the role of the Nation's largest collector and distributor of grain. It allows the market to distribute grain. It is a market-oriented system of inventory management for producers, for grain dealers and for CCC. It saves CCC vast sums in handling, storage, transportation, and administrative costs.

In conclusion, the USDA is very pleased with the success of using commodity certificates. We think benefits are accruing to the American producer, to American industries, and the Government. We look forward to their continued use and benefit to all parties.

Mr. Chairman that concludes my remarks. We will be happy to answer any questions that you or members of the committee may have.

Senator HARKIN [acting chairman]. Thank you.

Senator Boschwitz.

73-232 - 87 - 2

Senator BOSCHWITZ. If you had made that statement before those fellows had left, I would not have had to ask all those questions. You would not have had to wait so long to testify.

I also noted on the bottom of page 10 of your prepared statement when you said, accordingly, the use of certificates precluded the need for $450 to $500 million in additional outlays for handling surplus grain last fall. And also, getting them marketed means that the price is going to recover sooner. Leaving them in CCC storage and hanging them over the market and, yes, maybe it is only 200 million bushels, but that is how you have to start. I think it was indeed very helpful.

You answered all my questions, Mr. Amstutz. Let me ask you just one thing.

Are the GAO boys still here? What was that term that the gentleman used? He would have been helped by your testimony. I presume that you made these arguments to them as well. Did they ask?

Mr. AMSTUTZ. I had a very brief session with them. I forget how long it lasted, just before they finished the report, they met with others of our people. We are just beginning the process of reviewing their report. We have found many, many areas where we disagree.

They did not give us the option of providing input into the report for publication prior to it being published; frequently they do, but in this case they did not.

Senator BOSCHWITZ. Did they come around and talk to you, Mr. Bailey?

Mr. BAILEY. Last Friday, Senator, they gave us five or six summary pages of their conclusions, and a draft of the report. Today is my first opportunity to see the final report. A cursory examination, on my part, of their draft has uncovered literally 100 issues which I find incorrect, disagree with, or facts that are not consistent with what is going on.

Senator BOSCHWITZ. It just seemed to me that we marketed a lot of grain. Farmers made some money with these PIK certificates. It is very hard to quantify the losses, the amount of grain that moved and that you did not have to store and that did not hang over the market. It just seemed such a good program to me.

Thank you, Mr. Chairman.

Mr. AMSTUTZ. Senator Boschwitz, may I just make a comment? As I think I said in my testimony, I really think our estimates of savings are understated. They are very conservative.

I heard you raise the question of perhaps $700 million savings when the GAO people were here. It is hard to document these things; that we all agree. But in no way would I think that $700 million savings figure is an outlandish estimate. The savings were significant.

Senator BOSCHWITZ. And also, the quality loss that would happen to grains if they stayed in storage long, as I mentioned.

I thought that it made sense to me as a businessman, and I thought that it worked well. I had a lot of very favorable comments about it. Interestingly, as I mentioned to you, one young man who talked to Mr. Mosely—whom I believe is a witness today—figured out how to go into business with the use of these PIK certificates.

Those farmers know how to use these things, to figure out how to use them between North Dakota and Texas.

Mr. AMSTUTZ. May I make another comment about that that might be interesting to everyone.

Senator BOSCHWITZ. Sure.

Mr. AMSTUTZ. When we were thinking of adopting this program, one problem we had was that we knew that it would be difficult for many people to understand. You quickly learn in this town, in this business we are all in, that communication and understanding are enormously important. So, before you come out with a new program, you ask a very important question: will people understand it?

But then it dawned on us that one group that would have no problem understanding it would be the farmers.

Senator BOSCHWITZ. Senators have more trouble.

Mr. AMSTUTZ. Well, I will not comment on that.

And when and as that dawned on us, that gave us the confidence to proceed. I think events have proved that. I think the farmers do understand it and have since the very beginning of the program.

Senator BOSCHWITZ. Thank you, Mr. Chairman.

Senator HARKIN. Senator Bond.

Senator BOND. Thank you, Mr. Chairman.

Maybe it would help our understanding if you explain to us the scam that you blocked, the long-distance PIK and Roll. Tell me one more time how that works.

Mr. AMSTUTZ. I think I will have Mr. Klopfenstein tell us about that.

Senator BOND. I think maybe if we can figure out what it was that you——

Mr. AMSTUTZ. I would like him to explain it and then perhaps I will comment after he does.

Mr. KLOPFENSTEIN. Farmers or producers can substitute their own inventory for inventory at another location. They do that because they do not have storage at their place. They can market their grain, acquire grain in another location. Then they can get price support on that, or they can PIK and Roll, if they like.

Loan rates are fairly stable throughout the country. They do vary, but they are fairly stable. Market prices vary greatly. So, the producer in this case would look for a spot where he could acquire some inventory at a place where the price was very low compared to the loan rate. And he would acquire inventory there. Then he would get a loan on that inventory immediately paying it back with certificates. He would pick up maybe 30 or 40 cents difference between loan rate and market price at that location as compared with loan rate and market price in his own home county.

Senator BOSCHWITZ. Then he has the corn up there, does he not?

Mr. KLOPFENSTEIN. Well, when we made the decision to terminate that process, yes, it was dislocating inventories. It was causing grain to move from the central Corn Belt up into Dakota into places where the price was very low, which is contrary to normal market movements. Grain usually moves toward a higher price; in this case it was moving toward lower prices.

Mr. AMSTUTZ. From a spacemaking standpoint, that was good for us.

The element that created the opportunity, we created by the program an arbitrage opportunity, because we had these differences. The one thing, the loan rates that have been in existence, as I frequently say since Moses brought them down from Mt. Sinai, and then these new market prices at these various locations, and the differences differed. By providing both those flexibilities, the substitution flexibilities under the loan and then the right to redeem with the certificates, we created that arbitrage concept.

When this came to our attention, we knew as this came to our attention that we had to address it. But we did not want to throw the baby out with the bath water. We wanted the space-saving attributes of this program, or the space-making attributes of this program to remain. Yet, we did not want what truly was not an intended use of the program to continue, for all good reasons. We decided that by simply not allowing both loan substitution and redemption to be used simultaneously, that we would solve the problem. Circumstances since then have told us that we have solved that problem.

We regret that it happened. We did not expect it.

Senator BOND. On page 10 of your prepared statement you talked about the 250 million bushels that would have been forfeited to CCC as well as 250 million bushels that were acquired by using the certificates. In essence, you reduced storage by about 500 million bushels.

In your calculations, did you figure out what impact taking that 500 million bushels out of the marketplace would have had on price? Did that have a price impact? And did the Government as a result of that price impact in this case, more stocks on the market, lower prices, have to pay more? Is that part of your calculations?

Mr. AMSTUTZ. Well, yes, and that is the recycling argument, too, Senator. We do know that whenever the Government causes additional stocks to be placed on the market, that logic says that it tends to have a price depressing effect. We understand that. Our desire was never to have so many certificates out in the market so that we would create a significant market depressing effect over and above what would have occurred otherwise, because we did not want a lot of recycling.

We knew that recycling would add to the cost of the program and could quickly, if not controlled, cost the program out of being sensible. Unfortunately, in these things there is more art than science in determining how much room there is for added stocks on a market.

Senator BOND. Did you make any artful estimate as to the cost or to the impact on prices?

Mr. AMSTUTZ. Oh, goodness, continual.

Do you want to comment on that, Bill?

Mr. BAILEY. Certificates were going out to the market from May through when the corn harvest started. So, we broke down almost a monthly potential certificate impact on the market, with certificate redemptions translated into wheat or into corn.

Looking at the market conditions at that time, futures prices, even when the President signed the farm bill, were below loan redemption rates for corn. We recognized demand toward the end of the summer was not very strong to begin with. Combine that with

the whole-herd buyout, a lot of cattle coming onto the market, reduced demand for feed and reduced demand in the livestock sector. It was not a very good environment to market corn. Loans would have been forfeited to us.

So, as we looked at what the certificates were doing month by month, in order to bring some corn onto the market, prices had to go below the loan rate. Our analysis was done in increments of 4 cents, 5 cents, and ended up around 10 cents the latter part of the summer, below loan redemption levels. It went even lower than that as certificates became more aggressively used following harvest.

Mr. AMSTUTZ. One thing that helped us in this, dealing with this art versus science, is that we were helped by the fact that the huge majority of the farmers were in our programs. In the area of corn, a majority of the farmers that are not in our programs tend to be feeders, tend to be farmers that buy corn. The farmers that are in our programs were not hurt by prices going subloan. And feeders were not hurt by prices going subloan. So, there were no losers in that regard. Now, there are always some but——

Senator BOND. There were a lot of Missouri farmers who lost the year's winter wheat crop with the freeze, and they went out and planted corn without having, many of them, without having a corn base. They got a shellacking.

Is there any estimate as to how much those 500 million bushels might have brought down the price, or how much more for commodities in the programs the Government had to pay out because those 500 million bushels were on the market and not in storage?

Mr. AMSTUTZ. Of course, we tried to net that out in this testimony.

Senator BOND. You have made that in the testimony?

Mr. AMSTUTZ. Yes.

Let us send up this specific calculation on this particular thing.

Senator BOND. All right.

Mr. AMSTUTZ. But we did net it out in total. But we will send it up, if we may, Senator.

Senator BOND. Thank you. I hope I will find it informative.

[See page 46 for the supplied material.]

Senator BOND. Thank you, Mr. Chairman.

Senator HARKIN. Thank you, Senator Bond.

Mr. Amstutz, some analysts have compared the generic certificate program to de facto marketing loan program for corn. Do you agree with that?

Mr. AMSTUTZ. I surely agree that there are some similarities.

Senator HARKIN. Similarities. How do they differ, then? If they are not exactly alike, how do they differ?

Mr. AMSTUTZ. Well, the vehicle of the certificate itself. And some analysts have likened the certificates themselves to currencies. Often I have said, too, there are similarities but there are differences. The great similarity between this and marketing loan is that more goods are put onto the market as opposed to being isolated from the market. The market loan causes more goods to be marketed, to be put onto the market.

Senator HARKIN. A marketing loan would permit more goods to be put on the market?

Mr. AMSTUTZ. Yes.

Senator HARKIN. But is not that what you are saying one of your goals——

Mr. AMSTUTZ. That is the similarity, yes.

Senator HARKIN. That is one of your goals, as you have said, in this program.

Mr. AMSTUTZ. Yes.

Senator HARKIN. So, you say there are more similarities than there are differences.

Mr. AMSTUTZ. Yes. We always hate to be drawn into that discussion, for reasons I am sure the chairman understands.

Senator HARKIN. Well, that leads me to my next question. What is the Department's position on a marketing loan for feed grains and wheat?

Mr. AMSTUTZ. We are opposed to it. We are opposed to it in large part for cost reasons. Our cost estimates as we run costs on this are quite large. In this era of all of us trying to deal with this budget deficit, any programs that have a big price tag we have great problem with, Senator.

Senator HARKIN. I just wanted to point out that there is a great similarity between this and the marketing loan.

The Congressional Budget Office has proposed eliminating the quick PIK transition, in other words requiring the current crop loans be paid off at the loan rate rather than at the average, at the county posted price. They are estimating that savings are $1.4 billion over 5 years if they modify this.

Do you think this would be good policy to do as CBO suggests?

Mr. AMSTUTZ. No. My feeling is no. But my feeling on things like this is always that I believe they should be thoroughly studied and debated. But my feeling is that we surely did have glitches in the program early on. We have done our best to eliminate those that appeared. I think it is a pretty good program right now. It makes a lot of sense.

Senator HARKIN. I guess that if you are opposed to marketing loans, I do not know why you would not be in favor of the CBO's proposal then.

Mr. AMSTUTZ. Our argument is that, as you saw from my testimony, Senator, and one big difference of opinion between CBO and actually the GAO and us is the cost of the program. There certainly is a difference of opinion.

Senator HARKIN. Well, again, I hate to deflate your idea that this PIK program is a new program. If my memory serves me correctly, the first time the PIK was proposed as a program was under the Benson administration in 1959, either 1958 or 1959, when they first came up with the idea of PIK certificates. In fact, then-candidate Nixon in 1960 proposed that as part of his platform, part of his proposal when he was running for President, PIK certificates. So, it has been around a long time, it is nothing new.

Mr. AMSTUTZ. Clearly. The nuance here is the generic nature of them and they are denominated in dollars not bushels.

Senator HARKIN. I cannot remember if they talked about generic or crop specific.

Mr. AMSTUTZ. My memory is that they were crop specific and denominated in bushels.

Senator HARKIN. That could have been right. But it was the same idea.

Mr. AMSTUTZ. Oh, sure.

Senator HARKIN. Paying them and the certificates to be redeemed rather than——

The CHAIRMAN. It was before I was old enough to vote, so I did not pay attention. But I will go back and check it.

Senator HARKIN. Well, it is there. I think the arguments that were used at that time in opposition to it I think are still valid today. Namely, that you are trying to take care of a very bad situation, and that is huge surpluses, by depressing the price just about as much as you can. I just do not see any benefit either to farmers or to us as a Nation by continuing this course of events.

Now, I would agree with you that a PIK certificate benefits an individual farmer, sure, they get a benefit from it. I tend to think it is more short-lived benefit perhaps than what is going to accrue to them down the road. But I just do not see any benefit at all in driving these prices lower and lower and lower all the time. I keep saying I just have never had an economist or a noneconomist ever explain to me how it would benefit us as a country if we could export 5 billion bushels of corn every year for a dollar a bushel or for 75 cents a bushel. I just do not know what that gains us.

Mr. AMSTUTZ. It would not benefit us if that was an ongoing, never-ending occurrence.

Senator HARKIN. But when is it going to end?

Mr. AMSTUTZ. None of us knows for sure.

Senator HARKIN. Oh, I see.

Mr. AMSTUTZ. But there is an old saying, Senator, that I believe has been proved true over the centuries: the cure for low prices is low prices, just as the cure for high prices is high prices. In other words, the higher prices go, the more production in whatever the commodity or product is, comes onto the market, and therefore forces prices lower. And the lower prices go, the more costly it is for some to produce, and production gets to be in better balance with supply. It has proved out.

We would say in defense—I understand what you are saying. We would say in defense of this program, it has enabled usage to increase. There are demand elasticity realities at work. By usage increasing, farmers have profited from it, certainly those farmer feeders have. And we have less inventory to be held over the market.

Senator HARKIN. I do not think there is much demand elasticity out there. I have never had that proven to me. A little bit, but not enough to take up the slack of the surplus that we have.

But again, as you say, through this mechanism I think you are correct when you say, that eventually the production will come back in line with the demand, at some point down the road. At that point down the road, though, there are going to be a heck of a lot fewer producers than what we have right now. I think that is really the fallacy of this whole program. It may take us 3 years, it may take us 5 years. I do not know, maybe it will take us 8 or 10 years, but whatever it takes us, the rural areas of my State are going to be devastated, just devastated. Farmers are going to be off the farm. Our small towns are going to be gone. But when the pro-

duction comes back, and it will come back, few people are going to own all that land out there, a few people, much fewer than own it right now.

That is why I think that there has to be a better way through this period of time than just depressing the price. Quite frankly, I think this program is making farmers even more dependent on Government payments. I saw that last year, 46 cents out of every dollar that a farmer got in Iowa came from a Government payment, 46 cents. I think you and I would both probably agree that is unconscionable, at least I think it is unconscionable, that so much money comes from the Government to the farmer.

I would hope that we could get off of that. But I do not want to get off of it if it means that we have to drive half of our farmers off the land, consolidate land owning even more than it is. I think that was one of the reasons back in the early 1960's why we did not go along with the PIK program at that time. Other programs came along to take care of the overhanging surplus that we had at that time.

I understand we are going down this course, this road. There is nothing we can do about it right now. But I think as GAO has said, it is going to cost the Government more money. It is going to cause reduction in our income to our corn farmers.

The processors are going to make money. Boy, have you helped the processors. Have you seen what the profit margins have been for the food processors the last year?

Mr. AMSTUTZ. Yes, it has been quite good.

Senator HARKIN. It has been darn good. I mean incredibly good. In fact, last year, of 50 firms that we surveyed in the food processing business, their sales went up 6 percent and their profits went up 13 percent. All other industries, not food processing industries, their sales went up 3.9 percent and their profits went up 2.8 percent, just to give you some comparison.

The exporters are making money, and the purchasers are making money. The Soviet Union is buying corn from us cheaper than they can buy dirt right now.

Senator BOSCHWITZ. Do not buy a barge.

Senator HARKIN. Wait a minute now. The people who own those barges on which they are storing that grain, they are making pretty good money, are they not?

Mr. AMSTUTZ. Well, those storage uses are quite temporary. We had something like 2,000 barges and now how many, 200? So, we are emptying all those barges.

Senator HARKIN. You remember the question I asked Pillsbury that day up in Minneapolis. I said, if you want to get the Government out of everything, how about you getting the same price for storing your grain on those barges as the farmer gets for storing his grain in his own warehouse, in his own silo. Well, that was not quite what they were talking about, you see, because the farmer's storage cost is, what, 27 cents?

Mr. AMSTUTZ. 26½ cents.

Senator HARKIN. 26½ cents. And I think the average for some of these other companies in storing the grain on the barges is 30-some cents, 35, 37 cents, something like that.

Mr. KLOPFENSTEIN. It varied a lot. That could be near the average.

Senator HARKIN. About the average, though. They are both storing corn. Pillsbury stores corn on barges. Farmers store corn in the silo. The farmer gets 26.5 cents. Pillsbury gets 35 or 37, whatever that average was.

Mr. AMSTUTZ. There are some reasons for that difference, Senator, if we could mention those.

Mr. KLOPFENSTEIN. Well, I really think in terms of services and the kind of a business you are looking at with a commercial warehouse compared to a farmer, it really is no comparison, with all due respect to farmers and their bins. The costs, the services they provide, the labor that they have to hire, and the weighing and grading and cleaning and all that, what a farmer does, really, is no comparison, although he is responsible for weight and grade.

Senator HARKIN. He is responsible for the same quality in the grain when it comes out——

Mr. KLOPFENSTEIN. The other advantage that the farmer has is the rotation of stocks in the farmer-owned reserve where they can empty their bin and then refill it. In some years like last year, that was probably worth 26.5 cents or more, that alone.

Mr. AMSTUTZ. On the in and out, they have more flexibilities than an elevator operator does.

Senator BOSCHWITZ. The length of the contract varies, too. The length of the contract with the farmer is normally longer.

Mr. KLOPFENSTEIN. In the farmer-owned reserve, he is guaranteed—well, not guaranteed, but virtually guaranteed 3 years, whereas there is no guarantee in the commercial warehouse.

The CHAIRMAN. Senator Boschwitz.

Senator BOSCHWITZ. The Senator from Iowa was kind enough to allow us to ask questions first.

The CHAIRMAN. Senator Bond.

Senator BOSCHWITZ. He asked questions, too, but he may have more.

Senator BOND. I yielded my time to Senator Boschwitz or to the chairman, just so I could have a little bit when everybody is finished.

The CHAIRMAN. Why don't both of you go, and I will just finish.

Senator BOSCHWITZ. I just want to ask unanimous consent to submit for the hearing record a statement by Lawrence Neumann, who is president of Grain Marketing for Benson-Quinn Co. from the Minneapolis Grain Exchange.

The CHAIRMAN. Without objection, it will be entered into the record.[1]

The CHAIRMAN. Do you have anything else?

Senator BOSCHWITZ. No.

Senator BOND. Mr. Chairman, there were questions raised about whether these programs and the low prices would actually bring some improvement in the world markets. Do we not see in cotton marketing loans they have really turned the situation around? Is that a good example, or is it just the fact that the PRC got out?

[1]See p. 123 for the prepared statement of Mr. Neumann.

Mr. AMSTUTZ. The marketing loan program in cotton did not turn the world market around. What turned the world market around is we had crop shortfalls in some major producing areas in the world and even some pockets of problem in our own country. So, cotton production was significantly lower this past year. That moved prices up. So, it is God-created incidents that turned the cotton market around, not our marketing loan program.

Now, our marketing loan program made it possible for American cotton to be more competitive than it would have been prior to the market being turned around, and that is significant.

I am sorry when Senator Harkin was here, I would have added one comment to what he said, namely that I understand his concern about low prices. I think we all share that concern. That is one reason we worked so hard in this Uruguay round in trying to address these fair trade issues in agriculture and why we are committed to what we call a meaningful, comprehensive negotiation there. We think these things have to be resolved. We think that is the forum in which to do it.

Senator BOND. I have one final question. The people who are really hurting in my State and are very concerned, are the soybean producers. What is your current thinking about whether any programs will be made available other than the current support program? Frankly, many soybean farmers say after they had planned their operations on a $5.02 loan and then it dropped 25 cents, they were caught sorely off guard. Are you now looking at any programs or relief for soybeans?

Mr. AMSTUTZ. We are surely looking at lots of things, Senator. In a real sense, soybean farmers were caught in the program, so to speak, and I think inadvertently so. This is the kind of thing that can happen when there is dramatic change in farm programs. So, there is a great deal of empathy for their plight. The problem, unfortunately, is so complicated because there are two tangents to the problem.

The loan value problem that you have enunciated is one, and then a problem that is really quite scary, and that is the competitiveness problem of American soybeans and fear of soybean farmers that current loan level for soybeans relative to loan levels for corn and wheat will in fact hold an umbrella over other soybean producers in other countries and exacerbate this supply-demand balance problem. So, the problem is complex.

We surely are looking at it. We are working closely with people in your State. It is a man from your State who is president of the American Soybean Association.

Senator BOND. He has found me several times.

Mr. AMSTUTZ. I am sure he has.

We are surely working on it. It is a dilemma.

Senator BOND. Is it possible that you go with a target price and not——

Mr. AMSTUTZ. We cannot——

Senator BOND. What else can we offer beside empathy?

Mr. AMSTUTZ. Well, they would say that we can have a marketing loan, that the statute permits that. The problem with the marketing loan gets right back to cost again and all these budget problems.

I am copping out, and I know it.

The CHAIRMAN. As I was sitting here I felt as though we were just about to leapfrog three hearings. I was getting excited.

Mr. AMSTUTZ. I think I should stop. Other than to say it is a dilemma——

The CHAIRMAN. Oh, feel free. We will give you extra time.

Mr. AMSTUTZ. It is a dilemma, and we are looking at it.

Senator BOND. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Secretary Amstutz, you heard or are aware of the testimony of GAO here today?

Mr. AMSTUTZ. Yes, we had a summary of their report. I did not hear it all. I heard some of the questions and answers.

The CHAIRMAN. Any reaction?

Mr. AMSTUTZ. Mr. Chairman, when you were out of the room a while back, Mr. Bailey said that a cursory look at the GAO report—of the draft report, we had disagreement in 100 areas. So, there are a number of areas where we have substantive disagreement with the GAO report.

The CHAIRMAN. Is there any possibility of having you write down your areas of disagreement?

Mr. AMSTUTZ. Sure, we are happy to.

[See page 63 for the supplied material.]

Mr. BAILEY. Mr Chairman, we look forward to the GAO report because the literature, quite frankly, is limited on how to cost-out the certificate program. It is very complicated with a lot of variables. We look forward to the GAO report. I am a little disappointed in what I have seen so far, but I think if we work with them, we can come up with a pretty good methodology about getting some consensus in our budget estimates.

The CHAIRMAN. I would be anxious to see it because I suspect, as we go into some of the budget debates we are going to have on the floor, PIK will be part of it. I have a feeling that the PIK program as defined is going to be one of the top number of areas where people are going to be looking for savings. I am not sure just how you even define where the savings come from or how you analyze it.

Did you conduct any economic research on the effects of certificates on net loan outlays prior to issuing instruments?

Mr. AMSTUTZ. Yes.

Do you want to comment?

Mr. BAILEY. Yes, sir.

We have gone through both with certificates and without certificate analysis, looking solely at the loan activity, because we have offered loan opportunities to people who traditionally have had that opportunity foreclosed, such as feeders. We see more activity in the loan. We had a larger crop, more people eligible for the loan. So, we have seen more loan activity.

When you net out the storage and transportation and handling savings, that is where we think the cost-effective aspect of the certificate is most sharply focused.

The CHAIRMAN. After we get the whole transcript back, I will see whether the question has been answered. We may have the staff get together with you and discuss that answer further so we can

get some real specifics. I think it is extremely important to what we will be deciding here.

Mr. AMSTUTZ. We are happy to get together on this, because we agree with you, Mr. Chairman, it is important.

One area where we differ is, you see, we all agree that more comes into the loan initially. Then the question is, how much is defaulted and how much is redeemed. We tend to think that the data shows that the redemptions are quite high, plus these storage and transportation savings. But we are happy to work on this, as I say, Mr. Chairman.

The CHAIRMAN. But you can see how that will be part of the debate this year.

Mr. AMSTUTZ. Indeed.

The CHAIRMAN. And a significant one.

You mentioned some analysis on page 12 of your statement. You said you have analyzed the effects of the use of certificates today compared with the program under which no certificates would be issued for the 1986–88 fiscal years. You say based on this analysis it is estimated that outlays associated with loans with the issuance of $8.5 billion of certificates for this period could be as high as $550 million.

Could we get hold of that analysis?

Mr. BAILEY. We will be more than happy to explain how we came up with that number. I might add that because the cost estimate of this program changes, it is a dynamic program, and today's analysis, as the facts change, may not be tomorrow's analysis. Even now as we speak, that number, I suspect, the $550 million, is going to be appreciably less as we get further information back from certificate redemptions.

[See page 43 for the supplied material.]

The CHAIRMAN. Are you able to quantify benefits: things like storage?

Mr. BAILEY. Yes, sir.

The CHAIRMAN. How do the numbers for cost and benefits compare?

Mr. AMSTUTZ. Well, we think they balance off very closely. We think that we are very conservative on the benefits side and very liberal on the costs side. I will just sort of add tangentially, as you know, Mr. Chairman, testimony such as this has to be cleared by various agencies down the slope. So, this——

The CHAIRMAN. Some of those agencies would even say up the slope, but go ahead.

I agree with your analysis.

Mr. AMSTUTZ. So, this $550 million had to be acceptable to agencies other than our own, which would tend to be a little bit on the higher side on the cost estimate than we.

The CHAIRMAN. Now, that is looking at it for the past year, is that right?

Mr. AMSTUTZ. Yes.

The CHAIRMAN. Have you looked at it for the coming year?

Mr. AMSTUTZ. This is the 1986–88 analysis.

The CHAIRMAN. Do the costs and benefits change considerably from one year to the next?

Mr. AMSTUTZ. Well, we have only looked at certificates authorized and issued for the 1986 program and some 1987 program benefits. Certificates have savings over 3 fiscal years. We did a certificate no-certificate analysis. We analyzed how issued certificates would differ from absolutely no certificates issued over the same time period.

The CHAIRMAN. What about storage? Your storage picture is changing considerably.

Mr. AMSTUTZ. Well, it is. I would just say this. A sort of cursory analysis that can be done every year is to begin with the question, what does the storage demand picture look like for the new crop. And the tighter that picture appears, the more valuable a program such as this is.

Again this year, this year coming up, the crop-year beginning soon, the storage picture once again is tight, and programs that allow for flexibilities, that allow grain to move from tight storage low price situations to greater availability storage areas and higher price areas are helpful. By definition, the low price tight storage, of course, goes together. Where there is tight storage, that is where the prices are lowest.

The CHAIRMAN. I understand.

Gentleman, I thank you very much. The record will stay open. A number of other Senators will have questions. We will be sending those down to keep you busy.

[The following questions from Senators Leahy and Conrad and the Department's answers thereto follow:]

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

MAY 15 1987

Honorable Patrick Leahy
Chairman
Committee on Agriculture,
Nutrition, and Forestry
United States Senate
Washington, D.C. 20510-6000

Dear Mr. Chairman:

Enclosed are responses to your follow-up questions in regard to our testimony before the Senate Committee on Agriculture, Nutrition and Forestry on the subject of generic commodity certificates.

We appreciate the opportunity to provide this additional information.

Sincerely,

RICHARD W. GOLDBERG
Acting Under Secretary
International Trade and
Commodity Programs

Enclosures

QUESTION (Senator Leahy):

In your testimony before the Committee, you estimated that the net cost of the certificate program is no higher than one percent of certificate value. Please provide the Committee with the economic analysis that supports this estimate.

ANSWER: The full package of our economic analysis relating to the net cost of the certificate program is very detailed. For this reason, we will summarize our analysis in the table below. Our analysis, for the 1986-crops, was based on comparing two scenarios: (1) 1986-88 fiscal year costs assuming $9.5 billion of certificate issuances, and (2) 1986-88 fiscal year costs assuming no certificates except for legislated quantities (about $1 billion). The use of three fiscal years was necessary to allow the expiration and track the impact of all certificates issued for the 1986 crops and other programs listed under "Other Payments".

Item	Without Certificates			With Certificates		
	Wheat	Corn	Total	Wheat	Corn	Total
1986 Crop:						
Market Prices ($/Bu)	2.60	1.75	--	2.35	1.50	--
Domestic Use (Mil. Bu.)	1045	5370	--	1105	5450	--
Exports (Mil. Bu)	1003	1150	--	1025	1250	--
FY 86/88 Outlays: (Mil. $)						
Net Loan	2408	13364	15772	3548	19721	23269
Inventory	2000	3330	5330	1763	2985	4748
Deficiency Payments	7031	10316	17347	5345	8128	13473
Diversion Payments	86	1768	1854	19	884	903
Sales Receipts	-150	-1247	-1397	-150	-1137	-1287
Outlays, Subtotal	11375	27531	38906	10525	30581	41106
Other Payments: 1/						
Ethanol Program			50			--
"TEA" Program			237			--
"EEP" Program			644			--
Feed Cost-Share Program			100			--
Conservation Reserve Program (CRP)			199			--
Corn CRP Bonus			340			--
Cotton/Rice Advance Payments			582			--
Other Payments, Subtotal			2152			--
Total Outlays			41058			41106
Difference			--			+48
Percentage Difference			--			.56%

1/ The payments were made in certificates with the same total value under the "With Certificates" scenario, where the outlay impact is reflected in net loan and inventory activities.

QUESTION (Senator Leahy):

Please provide the Committee with the cost estimates and economic research conducted by the Department of Agriculture prior to issuing the first certificates in April 1986.

ANSWER: We are submitting for the record the following documents prepared by the USDA regarding the early development of the certificate program. Considerably more detail is available. However, the data enclosed is a general summary of early analysis.

COMMODITY CREDIT CORPORATION

FISCAL YEAR 1987 MID-SESSION REVIEW ESTIMATES--Fiscal Year 1985 Actual, FY 1986 and FY 1987 Estimated Outlays and Receipts by Expenditure Category
(dollars in thousands)

ITEM	FY 1985 ACTUAL	FY 1986 ESTIMATED	FY 1987 ESTIMATED	CHANGE FY 1986 to FY 1987
Outlays				
Loans - Commodity	$10,185,973	$17,272,330	$11,196,684	-$6,075,646
Loans - Storage Facilities	559	326	---	-326
Loans - Export Guarantee Claims	184,067	423,163	701,259	+278,096
Purchases 1/	2,616,065	3,745,059	3,105,757	-639,302
Storage and Handling	394,190	712,611	1,196,791	+484,180
Transportation	133,918	173,679	180,907	+7,228
Processing and Packaging	129,026	117,137	79,264	-37,873
Producer Storage Payments	328,994	454,564	687,279	+232,715
Loan Collateral Settlements	40,781	89,841	116,474	+26,633
Direct Payments	7,826,903	6,106,621	4,459,490	-1,647,131
Loan Deficiency Payments	---	40,673	78,000	+37,327
Whole Herd Buy Out	---	580,106	559,889	-20,217
Purchases of Red Meat	---	a/ (279,364)	a/ (77,228)	a/(-202,136)
Conservation Reserve Program	---	124,000	661,000	+537,000
Short-Term and Intermediate Export Credit Sales	72,475	---	---	---
Operating Expenses	354,639	465,580	429,348	-36,232
Interest Expenditures	1,851,641	2,019,826	2,008,791	-11,035
Other Expenditures 2/	1,102,697	2,152,357	2,192,041	+39,684
Total Outlays	25,221,928	34,477,873	27,652,974	-6,824,899
Receipts				
Repayments - Commodity Loans 3/	4,147,998	5,574,009	9,639,434	+4,065,425
Repayments - Storage Facility Loans	310,321	228,111	133,193	-94,918
Repayments - Export Guarantees	19,487	10,504	9,017	-1,487
Sales Proceeds 4/	1,757,563	1,872,294	2,638,587	+766,293
Repayments - Export Credit Sales	92,919	102,180	57,709	-44,471
Interest Income	417,122	270,149	555,302	+285,153
Operating Income	3,146	2,803	2,785	-18
Realization of Assets	67	250	250	---
Dairy Assessments	374,639	320,000	430,000	+110,000
Export Guarantee Fees	15,595	28,624	150,000	+121,376
Other Receipts 5/	295,252	942,316	79,522	-862,794
Total Receipts	7,434,109	9,351,240	13,695,799	+4,344,559
Net Expenditures Above	17,787,819	25,126,633	13,957,175	-11,169,458
Change in Working Capital	-213,988	270,000	250,000	-20,000
Net Expenditures, Support and Related	17,573,831	25,396,633	14,207,175	-11,189,458
Special Activities (Wool)	109,365	119,477	130,879	+11,402
TOTAL CCC NET EXPENDITURES	17,683,196	25,516,110	14,338,054	-11,178,056

PIK TRANSACTIONS INCLUDED IN:	FY 1985 ACTUAL	FY 1986 ESTIMATED	FY 1987 ESTIMATED	CHANGE
1/ PIK Purchases	$248,358	$1,045,619	$1,652,025	+$606,406
2/ PIK Entitlements and Export Enhancement.	702,444	$1,873,880	$1,826,107	-47,773
TOTAL	950,802	2,919,499	3,478,132	+558,633
3/ PIK Loan Repayments	-234,026	-1,045,619	-1,652,025	-606,406
4/ PIK Sales Proceeds and Export Enhancement	-720,803	-1,076,244	-1,826,107	-749,863
5/ PIK Marketing Certificates	---	-797,636	---	+797,636
TOTAL	-954,829	-2,919,499	-3,478,132	-558,633

a/ Outlays included in other expenditure categories.

NOTE: Gramm-Rudman savings are included with each individual commodity or program.

0044C-17

WHEAT: PIK DEFICIENCY AND DIVERSION PAYMENTS

ASSUMPTIONS

-- All producers required to take an advance.
-- Advance is 50% of total.
-- PIK varies from 5 to 25 percent of total
-- 50 percent of PIK loans comes from 9-month loans, marketed within 90 days of signup.
-- 25 percent PLD in PIK at 85 percent equal to 55 million bushels.
-- 50 percent of PIK comes from CCC, marketed within 6 months of signup.

Table 1. WHEAT: Quantity of PIK Marketings Under Various In-Kind Levels

% of total in kind	Mar-May	Jun-Aug	Sep-Dec	Total (1)
		--mil bu--		
5.0	41	23	45	109
7.5	51	29	57	137
10.0	60	36	69	165
12.5	70	42	81	194
15.0	80	49	94	225
17.5	91	55	107	253
20.0	102	62	121	285
22.5	113	76	135	317
25.5	125	77	149	351

(1) ncludes 55 million bushels of 2.5% PLD in PIK.

Table 2. WHEAT: Change in Base Farm Price Under Various In-Kind Levels.

% of total in kind	Mar-May	Jun-Aug	Sep-Dec
		--$/bu--	
0.0 Base price	3.20	2.50	2.65
5.0	-0.05	-0.03	-0.08
10.0	-0.07	-0.05	-0.08
12.5	-0.09	-0.08	-0.12
15.0	-0.12	-0.11	-0.15
17.5	-0.15	-0.14	-0.18
20.0	-0.19	-0.17	-0.20
22.5	-0.23	-0.20	-0.25
25.0	-0.26	-0.24	-0.29

CORN: PIK DEFICIENCY AND DIVERSION PAYMENTS

ASSUMPTIONS

-- All producers required to take an advance.
-- Advance is 50 percent of total deficiency.
-- PIK varies from 5 to 25 percent of total.
-- 67 percent if PIK comes from 9-month loans, marketed within 90 days of signup.
-- 33 percent of PIK comes from CCC, marketed within 6 months of signup.
-- 2.5 percent PLD in PIK at 80 percent of program yield equal to 155 million bushels.

Table 3. CORN: Quantity of PIK Marketings Under Various In-Kind Levels.

% of total in kinds	Mar-May	Jun-Aug	Sep-Dec	Total (1)
		--mil bu--		
5.0	145	54	80	279
7.5	177	66	100	343
10.6	209	78	120	408
12.5	243	90	141	474
15.0	277	103	162	542
17.5	312	116	184	612
20.0	348	129	207	684
22.5	386	143	230	758
25.0	424	157	254	836

(1) Includes 155 million bushels of 2.5% PLD in PIK.

Table 4. CORN: Change in Base Farm Price Under Various In-Kind Levels.

% of total in kind	Mar-May	Jun-Aug	Sep-Dec
	--$/bu--		
0.0 Base price	2.50	2.50	1.95
5.0	-0.08	-0.07	-0.05
7.5	-0.10	-0.09	-0.07
10.0	-0.13	-0.11	-0.08
12.5	-0.15	-0.16	-0.10
15.0	-0.18	-0.16	-0.12
17.5	-0.20	-0.19	-0.14
20.0	-0.23	-0.21	-0.17
22.5	-0.27	-0.25	-0.19
25.0	-0.30	-0.28	-0.20

RICE: PIK DEFICIENCY PAYMENTS

ASSUMPTIONS

-- All producers required to take an advance.
-- Advance is 50 percent of total.
-- PIK varies from 5 to 50 percent advance.
-- Producers accept PIK beginning April 15.
-- World price estimated at $6.00 rather than $4.20 in Budget Assumptions.
-- World price not announced until April 15. Marketings greatest July-December period.
-- Marketings include advance PIK and 27 million cwt. of 1985 and 1986 crop marketing loan.

Table 5. Quantity of PIK Marketings Under Various In-Kind Levels.

% of total in kind	March-Apr 14	April 15-June	July-Sept	Oct-Dec	Total (1)
		--Mil Cwt--			
5.0	0	9	13	9	31
7.5	0	10	13	10	33
10.0	0	10	14	11	35
12.5	0	11	15	12	38
15.0	0	12	16	12	40
17.5	0	12	17	13	42
20.0	0	13	18	13	44
22.5	0	14	18	14	46
25.0	0	14	19	15	48

(1) Includes 27 mil cwt. of marketing loan PIK.

Table 6. RICE: Change in Base Farm Price under Various In-Kind Levels.

% of total	March-Apr 14	Apr 15-June	July-Sept	Oct-Dec
		--$/Cwt.--		
0.0 Base Price	0.00	-0.01	-0.07	-0.10
5.0	0.00	-0.05	-0.11	-0.16
10.0	0.00	-0.07	-0.15	-0.21
12.5	0.00	-0.08	-0.18	-0.26
15.0	0.00	-0.09	-0.22	-0.31
17.5	0.00	-0.11	-0.25	-0.36
20.0	0.00	-0.12	-0.28	-0.40
22.5	0.00	-0.14	-0.32	-0.45
25.0	0.00	-0.15	-0.35	-0.50

UPLAND COTTON: PIK DEFICIENCY PAYMENTS

ASSUMPTIONS

-- All producers required to take an advance.
-- Advance is 50 percent of total deficiency.
-- PIK varies from 5 to 25 percent of total.
-- 67 percent of PIK comes from 9-month loans, marketed within 90 days of sign-up.

Table 7. UPLAND COTTON: Quantity of PIK Marketings Under Various In-Kind Levels.

% of total in kind	Mar-May	Jun-Aug	Sep-Dec
	--Thou bales--		
5.0	96	46	68
7.5	145	70	103
10.0	193	94	139
12.5	247	119	175
15.0	360	144	212
17.5	355	178	250
20.0	411	197	289
22.5	470	225	329
25.0	532	255	371

Table 8. UPLAND COTTON: Change in Base Farm Price Under Various In-Kind Levels.

% of total in kind	Mar-May	Jun-Aug	Sep-Dec
	--$/lb--		
0.0 Base Price	0.50	0.45	0.40
5.0	-0.01	-0.01	-0.01
7.5	-0.01	-0.01	-0.01
10.0	-0.02	-0.01	-0.01
12.5	-0.03	-0.02	-0.01
15.0	-0.03	-0.02	-0.02
17.5	-0.04	-0.03	-0.02
20.0	-0.05	-0.04	-0.03
22.5	-0.06	-0.04	-0.03
25.0	-0.07	-0.05	-0.04

SUMMARY OF CERTIFICATE PROGRAM OPTIONS

A. Immediate Actions

1. Offer additional 10% of 1986 crop wheat and feed grain deficiency payments in advance.
2. Offer a generic certificate option to producers in lieu of cash storage payments.
3. Implement the interest payment certificate program.
4. Offer a generic certificate option to warehousemen in lieu of cash storage and handling payments.

B. Subsequent/Later Actions

1. Offer advance 1987 crop deficiency payments with a portion paid in generic certificates.
2. Make a portion or all of the final 1986 deficiency payments in generic certificates.
3. Pay 5% of the 1986 crop deficiency payments for all program commodities in commodity specific certificates.
4. Implement as deemed necessary, a commodity specific bid PIK diversion program.

C. Quantities

Quantities in terms of dollars and grain or fiber for the various options are shown on page 3 of the attached paper.

D. Available Quantities of CCC Inventory and Producer Loans

Currently about 7.5 billion bushels of grain and 7.1 million bales of cotton are available for certificate exchange. (See page 5 of the attached paper for further details.)

E. Quantities Exchanged Under Certificate Program

As of mid-July certificates valued at about $500 million has been exchanged for about 255 million bushels of grain. It is estimated that about $1.2 billion in certificates were issued under the advance wheat and feed grain deficiency/diversion payment program. Due to reporting delays and paper work backlogs it is estimated that 2/3 to 3/4 of these certificates have been exchanged for commodities.

F. Pros/Cons for Placing Additional Generic Certificates Into the Market

The pros and cons are on pages 4 and 5 of the attached paper.

ASCS/CAD/7-28-86/(0439A-26-32)

COMMODITY CERTIFICATE OPTIONS

A. Possible Immediate Actions:

1. Offer an additional 10 percent of 1986 estimated wheat (19.8 cents/bu.) and feed grains (corn-11.1 cents/bu.; barley-10.4 cents/bu.; sorghum-10.6 cents/bu.; oats-6.1 cents/bu.) deficiency payments in advance. Such payments would be made using generic certificates.

2. Offer generic certificate option to producers in lieu of cash storage payments under the farmer-owned reserve (FOR), special producer storage loan program (SPSLP), and the 1985 crop 12-month loan extensions (reseal).

3. Implement the interest payment certificate program (IPCP) as authorized in section 1004 of the Food Security Act of 1985 for the 1986 wheat and feed grain loan programs. Under this program, if producers repay their loans plus interest a generic certificate for the amount of accrued interest is paid to the producers.

4. Give warehousemen storing CCC-owned commodities under CCC storage agreement the option of receiving a part or all of their storage and handling payments in generic certificates.

B. Possible Subsequent/Later Actions:

1. Offer advance 1987 deficiency payments on all program crops at signup, with a portion of such payments made in generic certificates. These payments could commence after October 1, 1986. Maximum advance deficiency level is 50 percent with not more than one-half of the advanced amount paid in certificates. (For 1986, one-fourth of the wheat and feed grain advance deficiency payments were made with generic certificates. Certificates were not used for advance upland cotton and rice deficiency payments.)

2. Make a portion (5 or 10 percent) of the final 1986 wheat and feed grain deficiency payments in generic certificates. The final deficiency payment schedule and the beginning dates for issuing generic certificates are shown below. Could pay entire final payment in generic certificates.

Commodity	5-month payments	12-month payments
Wheat	December 1986	July 1987
Corn	March 1987	October 1987
Barley	December 1986	July 1987
Oats	December 1986	July 1987
Sorghum	March 1987	October 1987

3. Pay 5 percent of the 1986 wheat, feed grain, upland cotton, and rice deficiency payments in commodity specific certificates. The timing of these payments would be the same as shown in item B-2.

4. As deemed appropriate, implement the bid payment-in-kind diversion program for the 1987 program crops (commodity specific certificates) that is authorized in section 1009 (Cost Reduction Options) . This program authority cannot be implemented until after the enrollment period has ended (March 30, 1987). Also, acreage diverted must be planted to the program crop. Certificates under this program would be made available at the beginning of the respective marketing years or a portion or all could be advanced. Probable timing would be as follows:

Commodity	Beginning of Bid Diversion Enrollment 1/	Beginning of 1987 Marketing Year
Wheat:		
Winter	April 1, 1987	June 1, 1987
Spring	May 1, 1987	June 1, 1987
Barley	May 1, 1987	June 1, 1987
Oats	May 1, 1987	June 1, 1987
Corn	June 1, 1987	September 1, 1987
Sorghum	May 1, 1987	September 1, 1987
Upland Cotton	June 1, 1987	August 1, 1987
Rice	May 1, 1987	August 1, 1987

1/ After crop is planted.

C. Possible Dollar/Quantity Amounts:

The following table shows the potential monetary value of certificates and quantities of commodities that could be released using the various options outlined above.

Item	Summary of Options 1/						
	Immediate Action			Delayed Action			
	A 1	A 2	A 3	B 1	B 2	B 3	B 4
COMMODITY							
Wheat:							
Certificate Value (mil. $)	230- 310	62-187	17-39	290-345	95-1885	155	680-1,360
Million Bushels	100- 135	26- 80	7-17	175-190	40- 835	65	310- 680
Corn:							
Certificate Value (mil. $)	425- 565	206-321	44-98	490-735	170-3480	285	2245-4,205
Million Bushels	250- 335	62-189	26-58	295-445	105-2245	175	1400-2,625
Sorghum:							
Certificate Value (mil. $)	40- 55	12- 37	6-13	50- 75	20- 360	30	215- 285
Million Bushels	25- 35	7- 23	4- 8	30- 45	12- 235	20	135- 185
Barley:							
Certificate Value (mil. $)	25- 35	9- 30	2- 4	30- 45	8- 170	15	110- 135
Million Bushels	23- 32	8- 27	2- 4	30- 40	8- 168	15	115- 140
Oats:							
Certificate Value (mil. $)	6- 8	--	.3-.6	5- 10	2- 45	5	5- 20
Million Bushels	7- 9	--	.3-.7	6- 12	2- 50	6	5- 25
Upland Cotton:							
Certificate Value (mil. $)	225- 285	NA	NA	125-185	40- 800	70	425- 635
Million Bales	2.1- 2.4	NA	NA	1-1.5	.3- 6.7	.6	2.0- 5.3
Rice:							
Certificate Value (mil. $)	95- 105	NA	NA	45- 70	15- 320	25	240- 38
Million Hundredweight	27.9-30.9	NA	NA	13- 20	4.4-94.1	7.4	73.8-118.5
Soybeans:							
Certificate Value (mil. $)	NA	NA	32-70	NA	NA	NA	NA
Million Bushels	NA	NA	8-17	NA	NA	NA	NA

1/ Option A4: Storage and handling payments at current inventory levels are over $800 million per year with transportation costs about $90 million. If all warehousemen opted for the certificate option, this would involve about 445 million bushels of grain. It is estimated that about 50 percent of the warehousemen would opt for the certificate option, if implemented.

D. Objectives:

-- Make additional certificates available to the market.
-- Ensure that adequate grain supplies are available to the marketplace at competitive prices.
-- Lower outlays of the commodity programs.
-- Minimize recycling of loan stocks.

E. Perferred Options:

The options believed to best meet the objectives outlined in Item D are A-1 and A-3. Both actions can be taken immediately and would be easily implemented.

At a later point it may be appropriate to give consideration to options B-1 and B-4.

F. Pros/Cons of Issuing Additional Certificates:

PROS:

-- Will increase the supply of certificates for exchange making additional commodities available to the marketplace at more competitive prices.
-- Will decrease cash outlays of deficiency payments, and if the IPCP is implemented it should minimize 1986 crop loan forfeitures.
-- Should contribute to increased use (both domestic and export) by lowering market prices.
-- Producers benefit since certificate payments are not discounted by the 4.3 percent (Gramm-Rudman-Hollings) factor and additionally such certificates will likely trade at a premium to the face value.
-- Will reduce the excessive stocks held by CCC and by producers in various loan programs. Currently, about 7.5 billion bushels of grain and 7.1 million bales of cotton are in inventory or under loan. These amounts are not likely to be reduced significantly other than through certificate exchanges.
-- Loan recycling should be minimized if the volume of certificates is controlled. Implementing options A-1 and A-3 should help to accomplish this objective.
-- Few problems are being encountered with the operation of the certificate program. Farmers and the trade seem to like the program.
-- Will help to temper storage problems by some increase in demand and by also permitting the trade to shift stocks using the certificate program.
-- Is positive to domestic users, both commercial as well as livestock, by making additional supplies of grain or fibers available at more competitive prices.
-- By immediately putting more certificates into the market, it increases the farmer's and the trade's marketing alternatives and flexibility.
-- Having additional certificates available to the market will enhance any subsequent export initiatives.

CONS:

-- Will likely lower premiums currently being paid for certificates. Premiums are near 20 percent in some locations.
-- Will have the effect of further lowering commodity prices. Farmers reactions will likely be negative as they traditionally do not like low prices.
-- Will contribute to loan recycling since prices for the 1986 crops of affected commodities will likely be at or below loan levels. However, this would likely be the case even without additional certificates being placed into the market.
-- Placing additional certificates into the marketplace now will effectively blunt any pre-harvest rally for feed grains.

G. Available Supplies for Certificate Exchange As of July 1, 1986 (does not include 1986-crop loan availability).

Commodity	CCC Inventory	Producer Loans FOR	SPSLP	9-month	TOTAL
Wheat (mil. bu.)	684.3	435.3	165.7	564.1	1,849.4
Corn (mil. bu.)	548.9	517.2	134.2	2,874.1	4,074.4
Sorghum (mil. bu.)	205.7	50.3	21.6	314.4	592.0
Barley (mil. bu.)	55.4	44.0	46.1	129.4	274.9
Oats (mil. bu.)	2.0	1.0	1.6	4.7	9.3
Upland Cotton (thou. bales)	752.1	NA	NA	6,389.0	7,141.1
Rice (mil. cwt.)	42.1	NA	NA	43.9	86.0
Soybeans (mil. bu.)	133.7	NA	NA	372.8	506.5

H. Certificate Exchanges to Date:

It is estimated that the total value of advance wheat and feed grain deficiency/diversion generic certificates will be $1.1 to $1.4 billion.

The following table shows the quantity of grain and estimated certificate value of exchanges through mid-July:

Commodity	Unit Measure	CCC Inventory	Producer Loans	Total Quantity	Estimated Certificate Value(mil $)
Wheat	mil. bu.	33.9	28.3	62.2	147.6
Corn	mil. bu.	24.0	89.7	113.7	246.7
Sorghum	mil. bu.	14.5	5.9	20.4	40.9
Barley	mil. bu.	14.8	11.1	25.9	32.3
Oats	mil. bu.	.2	.2	.4	.4
Rye	mil. bu.	.5	.2	.7	.9
Soybeans	mil. bu.	.4	.9	1.3	6.4
Rice	mil. bu.	28.0	--	28.0	42.6
TOTAL	mil. bu.	116.3	136.3	252.6	517.9

The data for CCC inventory exchanges are current however, producer loan data is lagged. It is estimated that from two-thirds to three-fourths of the issued generic certificates have been or will be exchanged for commodities by mid-August.

QUESTION (Senator Leahy):

On Page 12 of your written testimony, you state that the Department "analyzed the effects of the use of certificates to date compared with a program in which no certificates would be issued for the 1986-1988 fiscal years." Please provide us with a copy of this analysis, including all assumptions used to reach this conclusion.

ANSWER: A summary of USDA's analysis of the effects of the use of certificates authorized to date compared with a program in which no certificates, except those mandated, are issued for the 1986 wheat and feed grain crops is shown in a previous response. General assumptions of this analysis were:

a) Net amount of certificates issued: $8.5 billion (assumes total volume of $9.6 billion less $1.1 billion for certificate issuances that are mandated).

b) Mandated certificate programs: (1) farm program payment yields--Section 3 of the Food Security Improvements Act of 1986; (2) disaster payments under provisions of P.L. 99-500; and (3) the 2.5 percent mandatory paid diversion for the 1986 crops of wheat and feed grains.

c) Elasticity of demand varies by commodity but generally incorporates the -.35 being assumed by CBO. For every 10 percent decline in market prices demand will likely increase by 3.5 percent.

d) Loans made, repaid for cash, forfeited and placed into the farmer-owned reserve were determined using historical regression elasticities.

e) Certificate redemption distribution was based on activity to date and staff analysts best assessment of future flows.

f) Program provisions such as acreage reduction levels, target prices, loan levels and payment schedules were considered as announced for the 1986 and 1987 crop years.

QUESTION (Senator Leahy):

What disagreements do you have with the conclusions drawn by the General Accounting Office in their report on payment in kind certificates? Do you disagree with any of the facts set forth in the report?

ANSWER: Attached is a list of areas of disagreement with GAO's report. The Department's central disagreement focuses on GAO's conclusion that certificates increased outlays. USDA believes such a conclusion was not fully substantiated by GAO. Numerous issues were ignored by GAO which broaden the range of potential impacts to include limited to zero outlay impact of certificates.

QUESTION (Senator Leahy):

A list of "certificate objectives" was included in a packet of information sent to the Committee staff by the Agricultural Stabilization and Conservation Service. One objective is that certificates act as a quasi-marketing loan for wheat and feed grains at considerably less cost. Given the Department's opposition to implementing a marketing loan program for these commodities as authorized by the Food Security Act of 1985, please explain why the Department has chosen this particular objective.

ANSWER: Since producers can redeem loans with certificates at values less than the principal amount of such loans, this feature is similar to the marketing loan process. Thus, the certificate program results in being a quasi-marketing loan. Certificates have made market prices for wheat and feed grains more competitive, also an objective of a marketing loan. However, unlike a marketing loan the costs of the certificate program are controlled by the volume of certificates issued, while with a marketing loan the difference between the loan value and the loan repayment price (marketing loan gain) would be absorbed on all eligible quantities. This difference substantially reduces the cost of a certificate program over that of a marketing loan. In addition, the certificate program provides other significant impacts which a marketing loan cannot--access to CCC's inventory, market liquidity needed to overcome tight storage conditions, and more flexibility to livestock feeders to acquire needed feedstocks.

The Department continues to oppose marketing loans for wheat, feed grains and soybeans. The certificate program, along with our ability to lower loans for these commodities through the so-called "Findley Adjustment", will achieve our market-oriented objective at considerably lower budget costs and with significantly more widespread benefits to the agricultural sector.

QUESTION (Senator Leahy):

The Congressional Budget Office has estimated that requiring current loans to be paid off at the loan rate, rather than the posted county price, would reduce outlays by $1.4 billion dollars over 5 years. Do you agree with this estimate? What are the implications, aside from costs or savings, of such a modification?

ANSWER: We do not believe a savings of $1.4 billion over 5 years could be achieved by requiring current loans to be exchanged with certificates at a value not less than the loan rate. Since our estimates of cost are only about one-tenth of CBO's, we believe their savings are grossly over-estimated. The certificate program as it is being administered is working, is well liked, and is ensuring that a continuous flow of free grain stocks are, or can be, available at market prices. Changing the program to essentially eliminate the "Quick PIK" feature would dramatically change the program thrust. Certificate premiums would likely be lowered significantly, reducing producer returns. Since certificates could only be exchanged for prior year producer loans and CCC inventory, it is likely that with lower market prices current year loan activity would be increased and thus increase the volume of these loans being forfeited. This would not significantly change the "recycling effect" that exists with the current program. But, the proposed modification would increase CCC carrying charge outlays since CCC would have to pay in-charges on the larger volume of current year loan forfeitures. This cost is avoided with the "Quick PIK" opportunity.

We do not believe the CBO proposed change is in the best interest of the certificate program, and we further believe it will not significantly change the costs of the program over its current structure.

QUESTION (Senator Conrad):

GAO has testified that PIKs have lowered prices. Has USDA calculated the effects of PIK on the prices of wheat, corn, barley, etc? If not, please do so.

ANSWER: As a result of the certificate program, we estimate that 1986/87 marketing year prices were decreased by 15-25 cents per bushel for wheat and by 20-30 cents per bushel for corn. The price impact on other commodity prices such as barley and oats has been less significant. During the past 5 years, barley and oats market prices have averaged about 87 percent and 50 percent, respectively, of corn prices. However, during the period of October, 1986 through March, 1987 barley and oats prices have averaged 112 percent and 94 percent, respectively, of corn prices. This reflects a better supply/demand balance for these commodities than for corn.

QUESTION (Senator Conrad):

Has domestic use (demand) for food and feed grains per capita increased as a result of PIK use?

ANSWER: Domestic use of wheat and feed grains (corn) during the current marketing years is expected to increase by 89 million bushels and 425 million bushels, respectively, over the 1985/86 marketing years. It is estimated that a considerable amount of the increased domestic use for both can be attributed to the certificate program.

QUESTION (Senator Conrad):

Please document savings in storage, transportation, and handling costs. Do you have estimates available?

ANSWER: Through April 1, 1987 about 535 million bushels of 1985-crop 9-month wheat, corn, sorghum, barley and oats price support loans were exchanged with generic certificates. This loan grain would otherwise have been forfeited to CCC or placed into the farmer-owned reserve program. The annual interest, receiving and storage savings associated with this quantity of grain is over $300 million. Additionally, almost 270 million bushels of CCC inventory stocks has been exchanged with certificates through April 1, 1987. The annual carrying costs (interest, handling, storage and transportation) for CCC inventory is about $.65 per bushel, thus resulting in further savings of about $175 million in the first year. It is difficult to project how many years these stocks would have remained in CCC inventory, but similar savings would also accrue for each subsequent year these stocks remained in Government ownership. The following table shows, by commodity, the quantities of 1985 crop loans and CCC inventory stocks exchanged with certificates.

Certificate Exchanges,
April 30, 1986 - April 1, 1987

Commodity	1985- Crop Loans	CCC Inventory Stocks
	(Million Bushels)	
Wheat	60.13	58.37
Corn	412.60	89.23
Sorghum	21.61	28.03
Barley	35.81	29.85
Oats	.88	.60
Rice	--	58.83
Soybeans	2.25	.75
Rye	.57	2.41
Total	533.85	268.07

Further details are contained in response to Senator Leahy's questions.

QUESTION (Senator Conrad):

GAO argues that 90% of each bushel redeemed by PIKs finds its way back into CCC. If this is true, doesn't that reduce your cost savings estimate by 90%?

ANSWER: We agree that a degree of recycling has occurred with the certificate program. GAO estimates that for every 100 bushels of grain exchanged with certificates an additional 90 bushels finds it's way back into CCC. However, we estimate that the level of recycling is more likely in the range of 75-85 percent. Recycling does reduce the savings associated with carrying charges by about the percentage level of recycling, and we have factored this impact into our analysis.

QUESTION (Senator Conrad):

Please delineate the differences and similarities of PIK and marketing loans.

ANSWER: The generic certificate program is similar to the marketing loan in that producers can redeem loans at a value less than the original loan amount. However, the similarity ends there, and there are several key differences which make the certificate program a significantly more effective and efficient approach. The first is associated with costs. With the certificate program, costs are controlled by the dollar volume of certificates issued. But with the marketing loan, the difference between the loan and repayment price is absorbed on all eligible quantities. For wheat and corn, the implementation of the certificate program has resulted in market prices as competitive, or even more competitive (for corn), than if a marketing loan had been in effect, and at considerably less cost. We estimate the annual cost of implementing a marketing loan for wheat, feed grains and soybeans would be more than $1.0 billion compared with about $100 million with the certificate program. Another key advantage of certificates is that they provide ready access to CCC-owned stocks in cases where such stocks are better positioned, or provide the volume and quality needed, to meet market needs. The marketing loan approach would not authorize such access to CCC inventory. In addition, the certificate program provides considerable liquidity to the market which allowed us to get through last year's tight storage situation with a minimum of disruption, and will be a major factor in doing so again in the coming year. The marketing loan approach simply does nothing to ease storage problems beyond contributing to increased marketings. It may, in fact, exacerbate tight storage by forcing all commodities through the loan program. A further major advantage of certificates, over marketing loans, is that it has proven to give producers, livestock and poultry feeders and the trade considerably more flexibility to market grains effectively and profitably.

QUESTION (Senator Conrad):

You stated that the increase in cotton exports was not necessarily due to the marketing loan in cotton. Would U.S. cotton exports have increased without the marketing loan? If so, by how much?

ANSWER: All the increase in U.S. cotton exports for 1986/87 as compared to 1985/86 cannot be attributed to the marketing loan for cotton because other factors contributed to reduced 1986-crop production in several foreign exporting countries. For example, adverse weather conditions and a change in government policy resulted in a reduction in 1986 production of about 2.7 million bales in the Peoples' Republic of China (PRC). This is likely to result in a reduction in exports from the PRC of around 0.6 million bales. Adverse weather conditions reduced 1986 production in the U.S.S.R. by about 0.9 million bales. Exports from the U.S.S.R. are down about 0.2 million bales this year. Adverse weather also reduced production in several other countries. Because of the lower production and smaller exports in foreign countries, U.S. exports would probably have increased--perhaps by 0.5 million bales or so--even without the marketing loan.

QUESTION (Senator Conrad):

If the marketing loan program is not too costly for rice and cotton, why is it too costly for feed grains and rice?

ANSWER: We believe the marketing loan program for rice and cotton is too costly. However, the marketing loan program is mandated by law for upland cotton and rice. It is not a question of cost, but of complying with the mandate of the Food Security Act of 1985. The marketing loan gain for rice producers (50 percent of the $7.20 per cwt. loan price plus applicable marketing certificates generated whenever the prevailing world rice price is below one-half of the loan) amounts to over $200 per acre. For upland cotton, the marketing loan gain has averaged about $100 per acre. These per acre costs are considerably above what the associated marketing loan costs would be for wheat and feed grains. Further, we estimate that a marketing loan program for wheat and feed grains would also require implementation of marketing loans for soybeans, to maintain soybeans' competitiveness for land resources and to be equitable. A marketing loan program for wheat, feed grains and soybeans would cost an estimated $1 billion more annually than the currently administered generic certificate program.

QUESTION (Senator Conrad):

Please provide the 100 stated areas of disagreement with the GAO report on PIK.

ANSWER: The Department of Agriculture (USDA) was not permitted to formally respond to a GAO draft, nor did USDA have access to the final report until the Committee's hearing on March 26. USDA's testimony, which referred to 100 areas of disagreement with the report, reflected a review of an earlier GAO draft report. A similar review of the final report reveals many of the areas of disagreement between USDA and GAO were corrected in the final report. Thus, there has been a narrowing of the areas of disagreement, but there remains a plethora of disagreement that relate to assumptions, methodology and conclusions.

Central to USDA's evaluation of GAO's final report is USDA's desire for an objective, professional review of the certificate program. USDA worked closely with GAO in their preliminary survey work on certificate operations, and looked forward to GAO's findings. Their report was disappointing in its lack of clarity, in its methodology, and in its propensity to state conclusions with no attempt to explain how those conclusions were reached.

GAO selectively focused only on information consistent with its conclusions that certificates increase total outlays. Consistently, however, GAO slighted any potential areas which would have led to a different conclusion. For instance, GAO states "The outlay effects of certificates depend largely on how the certificates are used, which in turn depends on the market conditions prevailing for program commodities," and, "The effect of certificates on net loan outlays cannot be directly measured because many factors affect loan activity." Yet, other than recognizing those outcomes, they were ignored in GAO's conclusions. Also, GAO made no attempt to fully assess the market environment during the summer of 1985 in the absence of the certificate program. The grain supply-price scenario, with heavy supplies under CCC loan and huge 1986 crops eligible for CCC loan at sharply lower rates under the 1985 Farm Bill authority, assured massive loan forfeitures from the 1985 crops without the certificate program. The attendant potential costs and storage complications would have been significant. In addition, while GAO varied assumptions on certificate uses, it relied heavily only on those assumptions which increase outlays.

In summary, the report was disappointing, not from its conclusions, but from its failure to broaden the knowledge of certificate analysis. USDA wishes to have available credible analysis on certificates from many sources. GAO has not added to that body of literature.

The following areas typify how GAO erroneously stated issues, neglected to fully inform the reader, and/or selectively filtered analysis in the report:

1. GAO classified corn separately from feed grains. For all USDA analyses, corn is a feed grain. Such a classification, if continued in GAO's analyses, will overstate program effects. (pg. 10)

2. GAO stated that program eligibility is based on "reduction in planted acreage from predetermined production levels." Reduction in production is not a criterion for program eligibility. (pg. 10)

3. GAO used an incorrect and incomplete definition of "Findley amendments" payments. (pg. 10)

4. GAO neglected to mention that certificates allow loan and CCC inventory exchanges at levels well below statutory mandated levels. (pg. 12)

5. The quantity of bushels redeemable is principally a function of the exchange value of certain commodities, not the amount of certificates issued. (pg. 23)

6. GAO failed to take into account in its analysis of recycling the substantial (about 25 percent) decline in the wheat and feed grain loan rates between the 1985 and 1986 crops. Any balanced discussion of recycling must take explicit account of the huge 1985 forfeitures which would have taken place without certificates.
(pg. 23)

7. GAO failed to emphasize, in Example 2.1, that the loan recipient has always been eligible for the loan, but as a feeder, has been disenfranchised from using the loan. GAO should have addressed the question as to whether cost estimates were understated by ignoring this type of eligible program participant. (pg. 25)

8. GAO consistently ignored the role forfeitures should have in any analysis of certificates. (pg. 26)

9. GAO's Example 2.2, is incorrect in its description of loan forfeitures. Placing corn under loan and forfeiting that loan take place over time, 9 months, rather than one transaction. (pg. 27)

10. GAO did not explain or quantify "the price decline due to certificates..." What price decline, when and for what commodity? (pg. 28)

11. GAO superficially addressed storage problems as a major component of USDA's interest in certificates. USDA did extensive analysis of storage problems anticipated during the fall of 1986. By not more fully addressing this issue, GAO was selective in not examining data which may have been at variance with GAO's conclusions. While difficult to quantify, this issue had major positive effects on certificates. (pg. 34)

12. GAO failed to explain its statement, "There will also be a reduction in potential future revenues from inventory sales." CCC inventory would have been so isolated from the market, in the absence of USDA's certificate initiative, that any sales would have been unlikely for the foreseeable future. (pg. 38)

13. In detailing short-term handling costs, GAO is not sufficiently explicit as to how long they expected CCC inventory to be carried in the absence of certificates. A more detailed explanation would have been welcomed. (pg. 38)

14. GAO was selective in its use of facts in discussing loan placements. While this year's loan placements are ahead of last year for corn, wheat loan placements are well down. Most importantly, loan repayments for all commodities are much ahead of historical levels. This has implications on forfeitures. (pg. 41)

15. GAO stated that the storage crisis of 1986 was not as severe as predicted. On what basis does GAO make this claim? Might certificates have played a role? (pg. 41)

16. GAO neglected to mention that CCC loan placements are a function of cash flow requirements as much as, if not more than, a farmer's price expectations. (pg. 45)

17. GAO stated that farmers do not incur storage costs. In fact, the farmer pays storage, whether or not the commodity is under loan, unless he sells it. Certificates encourage a farmer to sell their grain unless the market is willing to pay the cost of carrying the grain. (pg. 47)

18. GAO failed to mention that certificates allow many of the marketing benefits available previously to the grain trade to now also be available to the farmer. (pg. 61)

19. In discussing PCP's (sic), GAO alleged improper pricing of certificates by USDA. GAO chose not to specify where the alleged improper pricing existed. (pg. 61)

20. In discussing long distance PIK and roll, GAO stated USDA waited to change that provision until "...the storage situation had abated to the point where the provision was no longer necessary." This implies delay and mismanagement by USDA. GAO's logic appears to support changing program provisions while they are still needed, rather than wait until they are no longer needed. (pg. 63)

21. GAO stated, as fact, that the price of a certificate is a function of the supply of certificates. USDA assumes GAO meant the premium or discount on a certificate is a function of the supply of certificates. GAO offered no empirical evidence to support its statement. (pg. 65).

22. We agree with GAO's assertion that "Different assumptions yield different estimates," yet GAO is judgmental and arbitrary to use only assumptions which substantiate their conclusions that certificates increase outlays. (pg. 67)

23. GAO was again selective in not more fully exploring the "many other factors besides certificates that affect net loans." (pg. 67)

24. A lack of rigor in its research is underscored by GAO noting "We must estimate the increase in net loan outlays." A more balanced approach would investigate changes in net loan outlays. ASCS's analysis did estimate changes in net loan outlays, and made that analysis available to GAO. They chose not to include that analysis, which showed minimal outlay effects of certificates. (pg. 67)

25. GAO is misleading when referring to EAS analysis. USDA believes that given that 75% of the EAS analysis assumed high recycling, it follows that the most probable effect of certificates is to increase outlays. The danger of such uncritical acceptance of analysis supportive of GAO's conclusions is contained in the same paragraph: "The analysis does not say what (recycling) percentage EAS believes is most likely," yet GAO then continues, "Given our estimates ... a recycling percentage of about 91-92 percent would produce an outlay increase in the range EAS believes most likely." ASCS believes 91-92 percent recycling is too high; what is the basis for GAO believing it is a valid factor? (pg. 69)

26. GAO cited other data sources to support their conclusions. GAO referred to World Agricultural Supply and Demand Estimates (WASDE), which GAO concluded shows little effect of certificates on usage. The WASDE reflect today's environment, not an environment without certificates. Consequently, cause and effect are not demonstrated. (pg. 69)

27. GAO again repeated their judgmental conclusions. While GAO conceded they have no idea what the loan-rate-to-PCP-ratio will be, they nevertheless conclude outlays will rise because the ratio will remain high. (pg. 71)

QUESTION (Senator Conrad):

Please provide detailed analysis of cost savings of PIK. Please specify all assumptions carefully.

ANSWER: The full package of our economic analysis relating to the net cost of the certificate program is very detailed. For this reason, we will summarize our analysis in the table below. Our analysis, for the 1986-crops, was based on comparing two scenarios: (1) 1986-88 fiscal year costs assuming $9.5 billion of certificate issuances, and (2) 1986-88 fiscal year costs assuming no certificates except for legislated quantities (about $1 billion). The use of three fiscal years was necessary to allow the expiration and track the impact of all certificates issued for the 1986 crops and other programs listed under "Other Payments".

Item	Without Certificates			With Certificates		
	Wheat	Corn	Total	Wheat	Corn	Total
1986 Crop:						
Market Prices ($/Bu)	2.60	1.75	--	2.35	1.50	--
Domestic Use (Mil. Bu.)	1045	5370	--	1105	5450	--
Exports (Mil. Bu)	1003	1150	--	1025	1250	--
FY 86/88 Outlays: (Mil. $)						
Net Loan	2408	13364	15772	3548	19721	23269
Inventory	2000	3330	5330	1763	2985	4748
Deficiency Payments	7031	10316	17347	5345	8128	13473
Diversion Payments	86	1768	1854	19	884	903
Sales Receipts	-150	-1247	-1397	-150	-1137	-1287
Outlays, Subtotal	11375	27531	38906	10525	30581	41106
Other Payments: 1/						
Ethanol Program			50			--
"TEA" Program			237			--
"EEP" Program			644			--
Feed Cost-Share Program			100			--
Conservation Reserve Program (CRP)			199			--
Corn CRP Bonus			340			--
Cotton/Rice Advance Payments			582			--
Other Payments, Subtotal			2152			--
Total Outlays			41058			41106
Difference			--			+48 2/

1/ The payments were made in certificates with the same total value under the "With Certificates" scenario, where the outlay impact is reflected in net loan and inventory activities. 2/ The certificate program is estimated to be $48 million, or 0.56 percent, more costly than a comparable program with only mandated certificates issued.

General assumptions of this analysis were:

a) Net amount of certificates issued: $8.5 billion (assumes total volume of $9.6 billion less $1.1 billion for certificate issuances that are mandated).

b) Mandated certificate programs: (1) farm program payment yields--Section 3 of the Food Security Improvements Act of 1986; (2) disaster payments under provisions of P.L. 99-500; and (3) the 2.5 percent mandatory paid diversion for the 1986 crops of wheat and feed grains.

c) Elasticity of demand varies by commodity but generally incorporates the -.35 being assumed by CBO. For every 10 percent decline in market prices demand will likely increase by 3.5 percent.

d) Loans made, repaid for cash, forfeited and placed into the farmer-owned reserve were determined using historical regression elasticities.

e) Certificate redemption distribution was based on activity to date and staff analysts best assessment of future flows.

f) Program provisions such as acreage reduction levels, target prices, loan levels and payment schedules were considered as announced for the 1986 and 1987 crop years.

QUESTION (Senator Conrad):

What are the Department's estimates (or range of estimates) of own-price elasticity of demand for wheat, feed grains, and soybeans?

ANSWER: We find little fault with CBO's demand elasticity of -0.35. Our estimates generally incorporate this elasticity.

QUESTION (Senator Conrad):

According to these estimates, what is the percentage increase in demand for wheat, feed grains, and soybeans resulting from a 10 percent decline in the prices of wheat, feed grains, and soybeans?

ANSWER: Increases in demand for wheat, feed grains, and soybeans resulting from a 10 percent decline in prices would be about 3.5 percent.

QUESTION (Senator Conrad):

Mr. Amstutz, it is my understanding that some PIK certificates have not been redeemed. In one particular case in North Dakota, a farmer was given certificates which were to expire in 5 days. (See attached copy of letter to Mr. Robert Christian, North Dakota State Director of ASCS.)

ANSWER: We recently took action on generic commodity certificates that expired December 31, 1987 through March 31, 1987. Original holders of these certificates may request that they be exchanged for cash. To apply for payment, certificates must be returned to the issuing county ASCS office by May 15, 1987, along with a written request for their cash exchange. Authorized payments for expired certificates will be equal to the face value minus 15 percent for handling and another 4.3 percent required by the Balanced Budget and Emergency Deficit Control Act of 1985. This action was taken since the certificate program is new and some original holders were unaware of the importance of using the certificates before their expiration date. This offer to pay original holders for expired certificates is being made one time only.

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United States Senate
COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

June 1, 1987

Honorable Daniel G. Amstutz
Undersecretary for International Affairs
and Commodity Programs
U.S. Department of Agriculture
Washington, D.C. 20250

Dear Secretary Amstutz:

Thank you for responding to the questions that I sent you on March 26 regarding generic payment-in-kind certificates.

Enclosed is your response to my question regarding cost estimates prepared and economic research conducted prior to the first issuance of certificates. As you can see, the first document--the only one dated prior to April 1986, the date of the first certificate issuance--is unreadable. The remaining documents, though they provide useful information, were prepared after April 1986 and therefore do not constitute a response to my question.

I would appreciate a more detailed response. Specifically, I would like you to provide the Committee with the results of estimates and analyses prepared prior to April 1986 on the following: 1) crop supply and demand with and without certificates; 2) impact on commodity prices with and without certificates; 3) impact on Federal budget outlays with and without certificates; and 4) any additional information compiled before that date.

If such research was not conducted, please provide the Committee with what was prepared instead.

Thank you for your attention to this matter. I look forward to your early response.

Sincerely,

Patrick Leahy

PATRICK LEAHY
Chairman

Enclosure

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

Honorable Patrick Leahy
Chairman
Committee on Agriculture,
Nutrition and Forestry
United States Senate
Washington, D.C. 20510-6000

JUL 17 1987

Dear Mr. Chairman:

Enclosed, per your request, are copies of reports prepared by Agricultural Stabilization and Conservation Service (ASCS) on generic certificates prior to the first certificate issuance in April of 1986. We have also taken the opportunity to provide you with a more readable copy of the report sent to you in May. That report analyzes certificate marketing levels and the farm price effects under various in-kind payment levels. The remainder of the reports generally deal with the operational aspects of the commodity certificate program. For example, the second and third documents discuss the particular commodities involved and procedures for the redemption of commodity certificates.

The final document, "Chronology of the Commodity Certificate Program," was prepared earlier this year. It provides a summary of ASCS actions taken in regard to the generic certificate program since January 29, 1986.

We appreciate the opportunity to provide you with this information.

Sincerely,

RICHARD W. GOLDBERG
Acting Under Secretary
International Affairs and
Commodity Programs

Enclosures

[illegible] PIK/Equivalent and Diversion Payments

ASSUMPTIONS

- All producers required to take an advance.
- Advance is 50% of total deficiency.
- PIK varies from 5 to 25% of total.
- 50% of PIK comes from 9-month or FOR loans marketed within 90 days of signup.
- 50% of PIK comes from CCC marketed within 6 months of signup.
- 2.53 PLD in PIK at 85% of program yield equal to 55 million bushels.

Table 2. CORN: PIK DEFICIENCY and DIVERSION PAYMENTS

ASSUMPTIONS

- All producers required to take an advance.
- Advance is 50% of total deficiency.
- PIK varies from 5 to 25% of total.
- 67% of PIK comes from 9-month or FOR loans marketed within 90 days of signup.
- 33% of PIK comes from CCC marketed within 6 months of signup.
- 2.53 PLD in PIK at 85% of program yield equal to 155 million bushels.

RICE: PIK DEFICIENCY PAYMENTS

RICE ASSUMPTIONS

- All producers required to take an advance.
- Advance is 50% of total deficiency.
- PIK varies from 1% to 50% of advance.
- Producers would accept PIK effective April 15.
- World price estimated at $6.00 rather than budget assumption of $4.20/cwt.
- World price not announced until April 15. Marketings therefore greatest in July-December period.
- Marketings include advance PIK and 27 mil cwt of 1985 and 1986 crop marketing loan PIK.

UPLAND COTTON PIK DEFICIENCY PAYMENTS

ASSUMPTIONS

- All producers required to take an advance.
- Advance is 50% of total deficiency.
- PIK varies from 5 to 25% of total.
- 67% of PIK comes from 9-month or FOR loans marketed within 90 days of signup.
- 33% of PIK comes from CCC marketed within 6 months of signup.

Table 1. WHEAT: Quantity of PIK marketings under various in-kind levels.

% of total in kind	Mar-May	Jun-Aug	Sep-Dec	Total (1)
	--Mil Bu--			
5.0	41	23	45	109
7.5	51	29	57	137
10.0	60	34	69	163
12.5	70	42	81	194
15.0	80	49	94	223
17.5	91	55	107	253
20.0	102	62	121	285
22.5	117	70	135	317
25.0	125	77	149	351

(1) Includes 55 million bushels at 2.53 PLD in PIK.

Table 3. CORN: Quantity of PIK marketings under various in-kind levels.

% of total in kind	Mar-May	Jun-Aug	Sep-Dec	Total (1)
	--Mil Bu--			
5.0	145	54	80	279
7.5	177	66	100	343
10.0	209	78	120	408
12.5	241	90	141	474
15.0	277	101	162	542
17.5	312	114	184	612
20.0	348	129	207	684
22.5	384	145	230	758
25.0	424	157	254	836

(1) Includes 155 million bushels at 2.53 PLD in PIK.

Table 5. RICE: Quantity of PIK marketings under various in-kind levels.

% of total in kind	March-Apr 14	Apr 15-June	July-Sept	Oct-Dec	Total (1)
	--Mil Cwt.--				
5.0	0	9	13	9	31
7.5	0	10	13	10	33
10.0	0	14	14	11	35
12.5	0	11	15	12	38
15.0	0	12	16	12	40
17.5	0	12	17	13	42
20.0	0	13	18	13	44
22.5	0	10	18	14	46
25.0	0	20	19	15	48

(1) Includes 27 mil cwt of marketing loan PIK.

Table 7. UPLAND COTTON: Quantity of PIK marketings under various in-kind levels.

% of total in kind	Mar-May	Jun-Aug	Sep-Dec
	--1000s Bales--		
5.0	90	40	68
7.5	145	70	103
10.0	195	94	139
12.5	247	119	175
15.0	300	144	212
17.5	355	170	250
20.0	411	197	289
22.5	470	225	329
25.0	532	255	371

Table 1. WHEAT: Change in base farm price under various in-kind levels.

% of total in kind	Mar-May	Jun-Aug	Sep-Dec
	--$/Bu--		
5.0 Base price	2.70	2.50	2.65
5.0	-0.02	-0.03	-0.04
7.5	-0.05	-0.05	-0.08
10.0	-0.07	-0.06	-0.10
12.5	-0.09	-0.08	-0.12
15.0	-0.12	-0.11	-0.15
17.5	-0.15	-0.14	-0.18
20.0	-0.19	-0.17	-0.22
22.5	-0.22	-0.20	-0.25
25.0	-0.26	-0.24	-0.29

AGS:CAD 17-Jan-86

Table 4. CORN: Change in base farm price under various in-kind levels.

% of total in kind	Mar-May	Jun-Aug	Sep-Dec
	--$/Bu--		
5.0 Base price	2.50	2.50	1.95
5.0	-0.08	-0.07	-0.05
7.5	-0.10	-0.09	-0.07
10.0	-0.13	-0.11	-0.08
12.5	-0.15	-0.13	-0.10
15.0	-0.18	-0.16	-0.12
17.5	-0.20	-0.19	-0.14
20.0	-0.23	-0.21	-0.17
22.5	-0.27	-0.25	-0.19
25.0	-0.30	-0.28	-0.22

Table 6. RICE: Change in base farm price under various in-kind levels.

% of total in kind	March-Apr 14	Apr 15-June	July-Sept	Oct-Dec
	--$/Cwt.--			
0.0 Base Price	0.00	6.00	6.00	6.00
5.0	0.00	-0.01	-0.07	-0.10
7.5	0.00	-0.05	-0.11	-0.16
10.0	0.00	-0.06	-0.15	-0.21
12.5	0.00	-0.08	-0.18	-0.26
15.0	0.00	-0.09	-0.22	-0.31
17.5	0.00	-0.11	-0.25	-0.36
20.0	0.00	-0.12	-0.28	-0.40
22.5	0.00	-0.14	-0.32	-0.45
25.0	0.00	-0.15	-0.35	-0.50

Table 8. UPLAND COTTON: Change in base farm price under various in-kind levels.

% of total in kind	Mar-May	Jun-Aug	Sep-Dec
	--$/lb--		
0.0 Base Price	0.50	0.45	0.40
5.0	-0.01	-0.01	-0.01
7.5	-0.01	-0.01	-0.01
10.0	-0.02	-0.01	-0.01
12.5	-0.03	-0.02	-0.01
15.0	-0.03	-0.02	-0.02
17.5	-0.04	-0.03	-0.02
20.0	-0.05	-0.04	-0.03
22.5	-0.06	-0.04	-0.03
25.0	-0.07	-0.05	-0.04

Please note this table is also on pages 46-49.

QUESTIONS AND ANSWERS

GENERIC PIK CERTIFICATES

1. Q. What commodities may be obtained with certificates?
A. All uncommitted commodities in CCC's inventory, currently:

Wheat	Rye	Cotton
Corn	Oats	Butter
Grain Sorghum	Rough Rice	Cheese
Barley	Soybeans	Nonfat Dry Milk
		Sugar

2. Q. How will commercial holders of certificates know where CCC-owned commodities are available?
A. Kansas City Commodity Office (KCCO) will to the extent practicable issue catalogs showing quantities, qualities, values, and locations of commodities.

3. Q. What commodities will definitely be cataloged?
A.

Wheat	Grain Sorghum	Corn
Soybeans	Rice	Rye, Oats, and
Barley		

4. Q. Who will receive catalogs?
A. Catalogs will be mailed by KCCO to all interested parties now on CCC's mailing list, including participants in the Export Enhancement Program and those storing CCC products which are listed on a catalog.

5. Q. How frequently will the catalogs be updated?
A. A daily listing of lots taken and any change in prices for lots on catalogs will be made available to the public by the posting of such information at Kansas City Commodity Office, 8930 Ward Parkway, Kansas City, Missouri. Additional quantities will be made available by issuing catalog supplements as needed.

6. Q. How will CCC determine which lots will be included in the catalog?
A. CCC will consider location, storage and handling costs and other marketing factors.

7. Q. Can a commercial holder of certificates redeem them for commodities not on a catalog?
A. Yes. The holder should contact KCCO for specific information on quality, quantity, location, and value.

8. Q. How does a certificate holder submit a request to redeem catalog commodities?
A. Offers must be made through the Easylink System. They will be accepted on a first come, first served basis. CCC will establish the price on the day the telegram, telex, or twx was available for accessing from the Easylink system.

9. Q. Where does a holder deliver a certificate for redemption?
A. Kansas City Management Office (KCMO)
8930 Ward Parkway, P.O. Box 205,
Kansas City, Missouri 64141

10. Q. After a request to redeem is accepted, how long does the holder have to deliver the certificate to KCMO?
A. If not received within 10 calendar days, CCC reserves the right to cancel the redemption request. If cancelled, the certificate holder must submit another request.

11. Q. Can a warehouseman holding certificates make an offer to redeem them for commodities stored in his warehouse?
A. Yes. Offers to redeem certificates for commodities not on a catalog stored in the offeror's own warehouse may be made by letter, wire, or telephone. If the inventory desired is on a catalog, the warehousemen should follow regular Easylink procedures.

12. Q. How will CCC release warehouse receipts for cataloged commodities?
A. KCCO will issue master loading orders for all commodities that are catologed to storing warehousemen releasing the warehouse receipts to them. The master loading orders will be issued when the warehouseman's CCC-owned inventory is cataloged. When certificates are received and verified by KCMO, KCCO will issue wire releases against the master loading order for cataloged commodities.

13. Q. How will CCC release warehouse receipts for cotton?
A. Warehouse receipts will be furnished by KCCO directly to the certificate holder and the storing warehouse will be issued a shipping order.

14. Q. When will title and risk of loss transfer to the certificate holder?
A. Title and risk of loss will transfer to the holder on the date of the wire release or, in the case of cotton, on the date of transmittal of warehouse receipts to the holder.

15. Q. When does storage stop for the account of CCC?
A. CCC will pay storage through 7 days after the date of the wire release or transmittal. Those receiving CCC commodities have protection at storage contract rates for both storage and handling rates for all commodities, except cotton, and dairy products, for 60 days after transfer of title.

16. Q. How will CCC release commodities not on a catalog?
A. Non-cataloged items will be released to certificate holders by normal documents (loading orders for grain and rice, shipping instructions for cotton, notices to deliver for dairy products). Any negotiable receipts will be furnished with those documents. Title, risk of loss, and responsibility for storage charges will be the same as for cataloged items. Prepaid loadout charges on rice will be recovered from the storing warehouse.

17. Q. How will cataloged lots be applied against master loading orders?
A. By wire release.

18. Q. When may certificates be redeemed by commercial holders?
A. Certificates will show expiration dates. For advance deficiency and diversion payments, producers will have 5 months from the beginning of the availability period (April 30) to obtain certificates and commercial holders will have an additional 3 months (until December 31) to redeem the certificates.

19. Q. Can a redeeming, commerical certificate holder be required to accept commodities stored in his own warehouse?
A. Yes. CCC will retain this option. However, use of the option will be limited to unusual circumstances such as when a quality problem is known to exist or in case of a contract violation warranting loadout of CCC-owned commodities.

20. Q. Can a warehouseman obtain loan commodities?
A. Yes. First he must purchase a certificate and then arrange with a producer who has loan grain to repay the loan with the certificate or obtain a CCC-685, "Authorization to Release Warehouse Receipts," from the producer to permit the warehouseman to obtain the warehouse receipt from the applicable county ASCS office.

21. Q. How often can commercial holders redeem certificates for CCC inventory?
A. Certificate redemption will be limited to once each calendar month per each legal entity unless the offer is for at least a carlot quantity.

22. Q. How will commodities be valued?
A. An instore market price will be determined by CCC on the day the offer is received. UGSA loadout rates for each storing warehouse will be shown on the catalog.

23. Q. How will quality and quantity differences be settled?
A. By agreement between the storing warehouseman and the redeemer of the certificate.

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QUESTIONS AND ANSWERS ABOUT THE REDEMPTION OF COMMODITY CERTIFICATES

NOTE: These questions and answers are current and correct as of 2-28-86. Because of the possibility of changes, if there is a difference between these questions and answers, and procedure or regulations, the procedure or regulations are correct.

Commodity certificates cannot be used to redeem upland cotton loans until August 1, 1986. Forfeiture action may be delayed at producer's option, for upland cotton loans maturing before August 1, 1986. However, if these loans are eligible for the optional 8-month extension, they may be extended in the normal manner.

The term "commodity certificates" as used in these questions and answers, means a value equal to the portion of the diversion payment and advance deficiency payment that must be satisfied with loan collateral or on which a commodity certificate may be issued, as applicable.

The terms "eligible commodity" or "eligible loan" means all outstanding commodity loans except upland cotton loans that mature before August 1, 1986.

1 Will producers be permitted to assign their commodity certificates?

No.

2 Will the value of commodity certificates be subject to setoff?

Yes.

3 How can producers use a commodity certificate earned on a participating farm?

Producers with 1 or more eligible CCC price support loans that were obtained in the county where the certificate was earned, must use the earned certificate value to redeem loan collateral.

Producers who have no eligible CCC price support loans may sell or trade their certificate to:

A A commercial warehouse or other entity who may exchange the certificate for CCC owned commodities.

B Another producer who may use the certificate to redeem CCC price support loans.

4 Can any loan collateral be redeemed with a commodity certificate?

Commodity certificates can be used to redeem any commodity pledged for a price support loan except peanuts and tobacco.

5 During what period will producers be able to redeem their loans to satisfy commodity certificates?

All loans, except upland cotton loans, beginning April 30, through September 30, 1986.

Upland cotton loans beginning August 1, through September 30, 1986.

6 May action be delayed on loans maturing March 31 (July 31 for upland cotton) for producers who want to redeem them with certificates?

Yes.

7 Will producers be permitted to redeem matured but unsettled loans with commodity certificates?

Yes. However, matured but unsettled loans must be redeemed with commodity certificates on April 30, 1986. (August 1, 1986 for upland cotton loans).

8 Will producers be permitted to liquidate outstanding loans between program announcement and the end of sign-up?

Yes. Producers may repay loans, or deliver or forfeit matured loans through sign-up.

9 Will producers earning commodity certificates be required to designate, at the time of sign-up, which loan or loans will be redeemed with their commodity certificates?

No.

10 Must any specific loan collateral be used to satisfy commodity certificates?

Any loan collateral except upland cotton, that is outstanding on the day following the last day of sign-up, must be redeemed with earned commodity certificates with the following exceptions:

A Producers who elected to deliver or forfeit loans that matured on or before March 31, will not be required to redeem those loans with commodity certificates. However, producers may elect to use them if desired.

B Producers will be permitted to repay outstanding loans at any time through the date of loan maturity.

11 Has a priority been established for redeeming loan collateral with commodity certificates?

Yes. Except as provided for in question 12, loans must be redeemed in the following order: Regular loans, special producer storage loans, and reserve loans.

12 If a producer who earns commodity certificates has more than 1 outstanding loan on the day following the last day of sign-up and 1 or more of the loans mature before September 30, 1986, will the quantity of loan collateral needed to satisfy commodity certificates be extended until September 30, 1986?

No. With the exception of upland cotton loans that mature before August 1, producers will be required to select which loan collateral will be redeemed with commodity certificates no later than the earliest maturity date of the outstanding loans.

13 Can producers forfeit or deliver loan collateral on matured loans when there is a outstanding certificate balance to be settled?

Only loans that mature on or before March 31 or upland cotton loans that mature before August 1, 1986 can be forfeited when there is a outstanding certificate balance to be settled. However, producers will be permitted to repay outstanding loans at any time through the date of loan maturity.

14 How will producers who have no CCC price support loans receive their payments?

Producers who do not have eligible loans or have an insufficient quantity of eligible loan collateral to satisfy their payments, will receive a commodity certificate.

15 If an insufficient quantity of eligible loan collateral is available to satisfy the earned commodity certificate value, will producers be issued a commodity certificate, at sign-up, for the commodity certificate value that exceed the loan redemption value?

No. All eligible loans must be redeemed before a commodity certificate will be issued.

16 How will the balance of a commodity certificate be settled after all loans have been liquidated?

If the value of commodity certificates remaining after the loan is redeemed is less than $100, producers will have the option of receiving cash or a commodity certificate.

If the value of commodity certificates remaining is $100 or more, a commodity certificate will be issued.

17 If the loan rate on a loan redeemed with commodity certificates has been increased to reflect transportation and handling charges, will a refund of the charges be required?

No.

18 If the commodity is not stored in the county where the payment was earned, what value will be used to determine the quantity of the loan that must be redeemed?

The value determined by CCC for all commodities will be based on the location where the commodity is stored.

19 Can a producer redeem a commodity certificate for cash?

Yes. Commodity certificates can be redeemed for cash under either of the following conditions but will be subject to the 4.3 percent Gramm-Rudman reduction:

A They are presented by the producer who earned the commodity certificates.

B They were acquired and used to redeem outstanding loan collateral and result in a certificate balance of less than $100, except as provided for cooperatives in question 53.

20 When can a producer redeem a commodity certificate for cash?

Between October 1 and October 14, 1986.

21 Where can the certificates be redeemed for cash?

At the county office where they were issued.

22 Is there a minimum value associated with issuance of commodity certificates?

If the value of commodity certificates earned is less than $100:

A Producers that have loan quantities available, may redeem the loan quantities to satisfy their commodity certificates or receive cash.

B Producers that do not have loan quantities available, may receive cash or request a commodity certificate.

23 If a producer who earns less than $100 in commodity certificates elects to receive cash, when will it be available?

When the advance cash payment is made.

24 As of what date will the redemption value be determined for loans redeemed to satisfy commodity certificates?

The earlier of:

A The date the producer redeems the loan to satisfy commodity certificates.

B September 30, 1986 (December 31, 1986 for purchased certificates).

25 What price basis will be used to determine the quantity of loan collateral that can be redeemed with a commodity certificate?

The quantity that can be redeemed will be based on a value as determined and announced by CCC.

26 May loans obtained in other counties be used to satisfy commodity certificates?

Yes, at the producer's request. However, all eligible loans obtained in the county where the commodity certificates were earned must be liquidated first.

27 Will producers be required to use the total commodity certificate value earned on a farm to redeem loan quantities at 1 time?

Yes. However, producers who earn commodity certificates from more than 1 farm will be permitted to liquidate loan quantities separately to satisfy the value of commodity certificates earned on each farm.

28 If a producer sells or trades a commodity certificate to another entity, can the bearer redeem the certificate for cash, at the county office, at the end of the availability period?

No.

29 What can a purchased certificate be used for?

Purchased certificates can be used to redeem commodities under loan, sold or traded to another individual or entity, or used to purchase commodities from CCC inventory.

30 What is the final date a purchased certificate must be used to redeem outstanding loans?

December 31, 1986.

31 Will producers who redeem reserve or special producer storage loans with commodity certificates continue to earn storage under the terms of the loan agreement?

Yes. Storage will continue to be earned until the loan is redeemed with commodity certificates.

32 Will additional storage compensation be made available to producers who redeem farm-stored reserve loans with commodity certificates?

No.

33 Must unearned reserve storage be refunded to CCC on loans used to satisfy commodity certificates?

Yes.

34 Must refunds for unearned reserve storage be made before the collateral is released?

Yes.

35 Will producers who redeem loan collateral with commodity certificates receive any special storage payments?

No.

36 Must loans obtained after April 11, but before a commodity certificate is issued, be redeemed to satisfy commodity certificates?

Yes, unless the loan is repaid before the commodity certificate is satisfied.

37 Will producers who have been issued a commodity certificate be required to use the certificate to redeem loans obtained after the certificate was issued?

No. However, producers may elect to use the certificate to redeem loans obtained after the certificate was issued.

38 If the value of commodity certificates earned will liquidate only a portion of a container of honey, how will the balance of the commodity certificates be settled?

Producers will have the option of receiving cash or a commodity certificate for the value of the commodity certificate remaining, without regard to the dollar amount to be settled.

39 Will prepaid "in" and "out" charges and/or prepaid storage on warehouse-stored loans redeemed with commodity certificates be refunded?

No.

40 If a certified loan has to be redeemed with commodity certificates, can that loan be converted to a measured loan and receive an additional disbursement?

Yes, if the request is made during the loan availability period.

41 Can loan collateral redeemed with commodity certificates be repledged for loan?

No.

42 Will a program similar to the harvest for PIK program be offered?

No.

43 If a producer has multiple loans, can a portion of each loan be redeemed with commodity certificates?

No.

44 Will commodities redeemed with commodity certificates be subject to liens?

CCC will not recognize liens on commodities redeemed with certificates.

45 How will joint loans be redeemed when not all producers on the loan earn commodity certificates?

If shares can be determined, the producer earning the commodity certificates must use the determined share of the joint loan.

If shares cannot be determined, the producers may mutually agree to redeem the needed quantity of the loan after signing a letter of agreement.

46 Will producers redeeming warehouse-stored loans with commodity certificates be allowed transportation assistance to relocate the commodity to the farm?

No.

47 Will CCC pay for the cost of splitting warehouse receipts?

Yes. The amount that CCC will pay will be announced later.

48 Can producers earning commodity certificates, who are members of a cooperative, market their commodity certificates through the cooperative?

Yes. However, any individual loans outstanding in the county where the commodity certificates were earned must be redeemed first.

49 Will producers be required to designate the cooperative at sign-up?

Yes.

50 How will CCC determine if a producer is a member?

Producers who designate a cooperative will be required to sign a designation document. The document will be sent to the cooperative. The cooperative may accept the producer's commodity certificates and agree to use them to redeem outstanding loans or reject them.

51 If the cooperative rejects the producer's commodity certificates, will the producer receive a commodity certificate?

Yes.

52 May a cooperative or producer who purchases commodity certificates use the certificates to liquidate their loans?

Yes. However, producer's and cooperatives must use any commodity certificates earned, or designated in the case of cooperatives, before they can use purchased certificates to redeem loans.

53 Can a cooperative receiving commodity certificates on producer's behalf receive cash for any commodity certificate balance remaining after all loans have been liquidated?

Certificate balances will be settled with CCC inventory unless CCC has insufficient quantities of inventory available.

54 Will producers or cooperatives redeeming cotton loans with commodity certificates be required to redeem the oldest loans first?

No.

55 When Form A cotton loans are redeemed with commodity certificates, must the bales be redeemed in the order that they are listed on CCC Cotton A-1?

Yes.

56 If CCC-813 is on file in the county office, can the cotton covered by the CCC-813 be redeemed with commodity certificates?

Yes. However, the cotton can only be redeemed by the buyer shown on CCC-813 on or after August 1, 1986..

57 Can producers redeeming cotton loans with commodity certificates redeem 1 bale at a time?

No. Producers will be required to redeem, at 1 time, the total value shown on the certificate being used to redeem the cotton loan.

58 If the value of commodity certificates presented to redeem a loan will liquidate only a portion of a bale of cotton, how will the balance of the commodity certificates be settled?

Producers will have the option of receiving cash or a commodity certificate for the value of the commodity certificate remaining, without regard to the dollar amount to be settled.

59 Will cotton loans needed to satisfy commodity certificates that mature before September 30, 1986, be extended until September 30, 1986?

If cotton loans needed to satisfy commodity certificates mature before September 30 and are eligible for the optional 8-month extension, they may be extended in the normal manner.

FARM PROGRAM FACT SHEET

Generic PIK Certificates
Wheat and Feed Grain Program Payments

United States Department of Agriculture • Agricultural Stabilization and Conservation Service
March 1986

1986 ADVANCE PAYMENTS

Producers may request advance deficiency payments when they sign up for 1986 wheat and feed grain programs. The advance deficiency payment rate is 40 percent of the projected deficiency payment rate. These payments are computed based on the intended acres of program crops and, if applicable, nonprogram crops and conserving uses.

If an advance deficiency payment is requested, the producer will receive:

1. A negotiable generic commodity certificate for 25 percent of the total advance deficiency payment plus the diversion payment, following the sign up period, and

2. A check for the cash portion of the total advance payment, as soon as possible after the producer signs up.

IF ADVANCE PAYMENT NOT REQUESTED...

If an advance deficiency payment is not requested, the producer will receive a commodity certificate only for diversion payment. Commodity certificates will be available for issuance by county ASCS offices beginning April 30. Producers who have commodities under loan will have until September 30 or the maturity date of a CCC loan, whichever is earlier, to redeem their certificate for their commodities under loan. Producers who do not have outstanding CCC loans to satisfy their certificate have until September 30 to market their certificate.

PIK CERTIFICATES

Payment-in-kind commodity certificates are generic, that is, not commodity specific. The certificates will be redeemable by producers for any regular, special, or farmer-owned reserve loan commodity, and by commercial certificate holders for any CCC-owned commodity. A producer may sell the certificate to a commercial entity for redemption in CCC-owned commodities or another producer who may use it to redeem either his commodity loans or CCC-owned commodities. Co-op members may also designate an approved co-op to market their commodity certificates on their behalf.

The quantity of a commodity redeemed for PIK purposes will depend on the per-unit value announced by the Commodity Credit Corporation on the day the certificate is presented for redemption.

SMALL PAYMENTS

Producers earning a total commodity certificate payment of less than $100 can choose to receive a check instead of the certificate.

OUTSTANDING CCC LOANS

Producers who have outstanding CCC loans on any commodity are required to use those loans to satisfy their commodity certificate payment. Loans may be redeemed from April 30 through September 30 at a value determined by CCC on the day of redemption.

Producers must generally use their loan collateral for regular loans, special producer storage loans, and reserve loans, in that order, to satisfy the commodity certificate.

Producers who do not have outstanding CCC loans to satisfy their commodity certificate payment have the choice of (1) selling the certificate to a commercial entity, which may present it to the Kansas City Management Office anytime before December 31 for redemption in any CCC-owned commodities at a value determined by CCC; (2) selling the certificate to another producer, who may use it to repay CCC loans or obtain CCC-owned commodities in the same manner as commercial entities; (3) designating an approved cooperative; or (4) retaining the certificate and returning it to the county ASCS office between October 1 and October 14 to exchange it for a check.

RESTRICTION

Producers cannot receive the cash portion of the advance deficiency payment and refuse the commodity certificates for the remainder of the advance deficiency payment. Producers must repay unearned storage.

CASH PAYMENT REDUCTIONS

To comply with spending reductions imposed under the Balanced Budget and Emergency Deficit Control Act of 1985 (commonly called the Gramm-Rudman-Hollings Act), payments to producers made by check for the 1986 crops will be subject to reductions of 4.3 percent. Commodity certificate payments will not be subject to the reduction unless producers elect to exchange the certificates for a check.

Both advance and final payments made by check for deficiency and diversion will be subject to the 4.3 percent reduction.

CHRONOLOGY OF THE COMMODITY CERTIFICATE PROGRAM

January 29, 1986 — Press Release 87-86. Announced additional provisions for the 1986 wheat and feed-grains programs stating that producers may request 100 percent of diversion payments and 40 percent of projected deficiency payments at signup. Twenty-five percent of the advanced deficiency payments and 100 percent of diversion payments are to be paid as payment-in-kind (PIK) certificates.

January 29, 1986 — Press Release 88-86. Producers may receive certificates for commodities in lieu of cash payments for program participation. The CCC will issue PIK certificates that are generic (not commodity specific) and are redeemable by producers for any regular, special or farmer-owned reserve loan commodity, and by commercial certificate holders for any CCC-owned commodity. Details:

-- Producers holding commodities pledged as loan collateral at signup must redeem that loan collateral to satisfy their PIK's.

-- The quantity of the loan collateral that must be redeemed for PIK purposes will be determined using the per-unit value announced by the CCC on the day the certificate is presented for redemption.

-- Producers who do not have commodities under loan, or whose commodities under loan are insufficient to meet their PIK entitlements, will be issued negotiable certificates in the net remaining amount.

-- The certificates may be used to purchase commodities in CCC's inventory or sold to commercial entities, other producers, or cooperative members. Certificates are redeemable only for CCC-owned commodities.

-- Producers may also redeem the certificates for cash during a two week period following the first transfer deadline, which begins five months after issuance.

February 12, 1986	Press Release 135-86. Payments made in-kind or by negotiable commodity certificates (CCC-6) will not be subject to Gramm-Rudman-Hollings Act reductions. Reductions of 4.3 will apply to payments for certificates that producers redeem for cash.
March 20, 1986	Press Release 281-86. The Food Security Improvements Act of 1986 authorizes additional payments in the form of commodity certificates to be made to producers whose 1986 farm program payment yield for a crop is reduced by more than 3 percent below the 1985 program payment yield.
March 24, 1986	Press Release 288-86. Clarifies that the same yield will be used when calculating the additional compensation for both deficiency and diversion payments.
April 9, 1986	Notice LP-1003. Establishes CCC wheat and feed grain values for redeeming commodities pledged as loan collateral with commodity certificates. Actions required include determining the average price differential between each county warehouse and the assigned terminal market for each commodity and class, if applicable.
April 18, 1986	To the Industry, Procedure KC-ECC-1. Short reference "Procedure for Exchanging Commodity Certificates for Commodity Credit Corporation Owned Commodities."
April 28, 1986	Press Release 458-86. Producers using warehouse-stored commodity loans to satisfy commodity certificate earnings are given the option of obtaining replacement warehouse receipts or receiving commodity certificates.
April 28, 1986	Notice LP-1012. County average location differential lists are provided to State and County Offices to determine wheat, feed grain, and soybean values for determining loan quantities to be redeemed using commodity certificates.

May 2, 1986	Press Release 490-86. Announced temporary program to assist financially distressed fuel ethanol plants. Program to begin May 10 and end September 30. Assistance is in the form of CCC commodity certificates. Ethanol producers can earn 1 bushel of CCC-owned grain for every 2 1/2 bushels of grain removed from the marketplace.
May 7, 1986	Press Release 511-86. Requirements for ethanol plants to apply for CCC commodity certificates announced.
May 12, 1986	Press Release 533-86. Comments requested on the 1987 wheat program regarding whether a portion or all of the deficiency or diversion payments should be made in the form of commodity certificates.
May 15, 1986	Press Release 556-86. Producers earning commodity certificates under the 1986 farm programs are no longer required to redeem their outstanding loan collateral but will be able to receive commodity certificates in the same manner as producer without CCC loans.
May 15, 1986	Notice LP-1022. Some county average location differentials changed.
May 29, 1986	Press Release 617-86. Compounding of benefits for participants in the temporary ethanol program not allowed.
June 6, 1986	Press Release 665-86. Cotton commodity certificates may be used only for obtaining upland cotton. Generic certificates issued under the 1986 wheat, feed grain and conservation reserve programs, may be used to obtain upland cotton.
June 16, 1986	Notice CN-695. County offices notified of procedure for satisfying commodity certificate earnings and delaying action on 1984 maturing upland cotton loans.

June 18, 1986	Announcement CCC-GEP-1. "Announcement And Offer To Provide Commodity Credit Corporation Commodity Certificates Under The Temporary Program To Encourage Use of Grain For Fuel Ethanol" issued.
June 27, 1986	Notice LP-1041. County offices authorized to sell CCC inventory in exchange for commodity certificates to expedite CCC inventory movement.
July 11, 1986	Suite filed in U.S. District Court for the Western District of Louisiana to stop the USDA's Temporary Ethanol Feedstock Assistance Program. The suit includes a request for the Secretary of Agriculture to consider views and arguments on whether to include non-grain based producers in the temporary ethanol assistance program.
July 15, 1986	Press Release 847-86. USDA announces hearing on ethanol program.
July 17, 1986	Notice CN-699. County offices are notified that beginning August 1, 1986, upland cotton loans redeemed with commodity certificates will be valued at the adjusted world market price in effect for the week the certificates are used to redeem loans.
July 18, 1986	Press Release 873-86. Provisions for the 1986-crop rice marketing certificate program announced. Generic negotiable marketing certificates will be made available to producers and eligible cooperatives selling rice or repaying CCC price support loans, if such sale or repayment is made when the prevailing world price for that class of rice is below the current loan repayment rate.
July 23, 1986	Notice LP-1051. Yellow corn prices are to be used for producers redeeming yellow and white corn loans with commodity certificates.

July 28, 1986	Notice To Exporters, Announcement GSM-500. Announcement of procedure for wheat exporters to acquire a CCC bonus (commodity certificate) under the Export Enhancement Program. Exporters may submit offers to the CCC to acquire a CCC bonus needed to make a commercial sale of eligible wheat competitive on the world market.
July 30, 1986	Notice CN-703. Revises Notice CN-699 to state that beginning August 1, 1986, upland cotton loans redeemed with commodity certificates will be valued at the adjusted world market price in effect for the day the request to redeem loans with certificates is filed.
July 31, 1986	Press Release 937-86. Payment rates for upland cotton certificates announced.
July 31, 1986	Notice LP-1059. Procedures outlined for producers who redeem their 1986-crop rice price support loans using commodity certificates at the world market price.
August 1, 1986	Press Release 938-86. The Secretary of Agriculture announced a cost-sharing program to aid drought strickern farmers in Southeastern States. Cost sharing payments are to be made in generic certificates. The Secretary also announced additional advanced deficiency payments to all 1986 wheat, feed grain, upland cotton and rice program participants. The advance payments shall be equal to 10 percent of the estimated deficiency payment and be made in generic certificates.
August 1, 1986	Notice To Correspondents. The President has decided to make U.S. wheat available to the Soviet Union at current world market prices in sufficient quantity to fulfill the terms of the U.S./Soviet Long Term Grain Agreement. U.S. exporters will be given generic certificates in sufficient quantity to make U.S. price competitive.

August 4, 1986	FAS Report PR 236-86. CCC bonus on sales of wheat to the Soviet Union announced.
August 8, 1986	Press Release 973-86. Comments are requested on 1987 feed grains program including whether a portion or all of the deficiency or diversion payments should be made in the form of commodity certificates.
August 11, 1986	Press Release 975-86. The CCC has determined to expand its temporary ethanol program to include producers who use not only whole grains, but also dry milling and wet milling products and syrups derived from such grains. Ethanol producers using only feed stocks derived from sugarcane or sugar beets, or commodities which are not in the inventory of the CCC, will still not be eligible to participate in the program.
August 14, 1986	Notice LP-1064. CCC is offering 9-month farm-stored nonrecourse distress loans to producers storing grain in temporary storage structures or on the ground to provide price support to all eligible producers. Producers will be compensated 5 cents per bushel for quality and/or quantity deterioration if they repay the loan with cash or certificates.
August 18, 1986	Notice LP-1067. County Offices instructed to expedite warehouse-stored loans because some producers are being deprived of price support benefits resulting from a critical shortage of commercial grain storage space.
August 20, 1986	Press Release 1026-86. Date for requesting early upland cotton inventory protection certificate payments extended.
August 22, 1986	Press Release 1038-86. Comments requested on 1987 rice program provisions including whether to require producers to purchase marketing certificates as a condition of permitting loan repayments at a reduced

	level, and whether a portion or all of the deficiency or diversion payments should be made in the form of commodity certificates or other in-kind compensation.
August 27, 1986	FAS Report PR 271-86. Export enhancement subsidy to be paid in the form of corn and soybeans from CCC stocks for export of frozen poultry to Egypt.
September 12, 1986	Press Release 1130-86. CCC lists initiatives to relieve grain storage congestion. Actions include sales of low quality grain, swapping and relocating, and delivering CCC-owned grain in exchange for certificates.
September 24, 1986	Press Release 1183-86. Romania eligible for barley under the Export Enhancement Program to subsidize U.S. exporters with CCC-owned commodities.
September 24, 1986	Notice LP-1081. Collateral redeemed with commodity certificates that secured 1986-crop commodity loans is considered free stocks and may be pledged as grain reserve replacement stocks or substitution stocks, "PIK and roll." This collateral shall not be repledged for regular 9-month commodity loans.
September 26, 1986	FAS Report PR 348-86. CCC accepts export enhancement bids for sales of barley to Saudi Arabia to be subsidized using commodity certificates.
September 26, 1986	FAS Report PR 350-86. Export enhancement bonuses to be paid in the form of generic certificates for sales of semolina to Algeria.
September 26, 1986	FAS Report 349-86. CCC accepts export enhancement bids for sales of wheat to Tunisia to be subsidized using commodity certificates.

September 26, 1986	FAS Report 353-86. CCC bonus announcement released for exports of wheat to the Soviet Union.
October 9, 1986	FAS Report PR 381-86. Generic certificates to be used for milled rice export enhancement bonuses effective October 15, 1986.
October 21, 1986	Notice LP-1093. County Offices instructed to provide compensation to producers who experienced losses because the County Office was delayed in releasing redeemed grain until after April 30, 1986.
October 21, 1986	Notice LP-1094. County Offices instructed to establish minimum adjusted CCC value for redeeming loans on damaged and low test weight feed grains and wheat with commodity certificates.
October 24, 1986	Press Release 1325-86. Participants of 1987 commodity programs to receive advanced payments for a portion of their estimated deficiency and diversion payments. Feed grain producers may request 40 percent of estimated deficiency and 50 percent of estimated diversion payments at signup. Rice and upland cotton producers may request 30 percent of their deficiency payments. Fifty percent of advanced deficiency and diversion payments to be made in generic certificates.
October 29, 1986	Press Release 1350-86. Because of the improved storage situation producers will no longer have the option of substituting their loan collateral using commodity certificates.
November 13, 1986	FAS Report PR 461-86. CCC accepts export enhancement bid for sale of dairy cattle to Indonesia to be subsidized using commodity certificates.
November 13, 1986	FAS Report PR 462-86. CCC accepts export enhancement bid for sale of barley to Cyprus to be subsidized using commodity certificates.

November 14, 1986	Press Release 1420-86. Rice loan differential between whole kernel milled rice loan rates set at $1.00 per hundredweight for 1987 rice program. In addition, producers having 1987-crop rice under loan will not be allowed to purchase marketing certificates when repaying their loan at the reduced rate under the marketing loan program.
November 17, 1986	Press Release 1422-86. Producers who receive commodity certificates dated November 17, or later, will have three months before the expiration date to submit certificates to the CCC for cash. In addition, producers will have until the expiration date shown on the certificate to transfer or sell their certificates. Previously, a producer could not transfer the certificate after the first transfer deadline and could receive cash only during a two week period following the first transfer deadline.
November 20, 1986	Notice To The Grain Trade. Grain industry members given notice of forthcoming changes in procedure for exchanging commodity certificates for CCC-owned inventory.
November 21, 1986	Press Release 1451-86. Revisions in commodity certificate exchange procedures announced to help insure that commodity values for redemptions accurately reflect market conditions and conform more closely to trade practices.
November 24, 1986	Notice LP-1103. CCC is implementing a multi-market pricing system to revise procedure for establishing commodity certificate values used to redeem wheat, feed grain, and soybean loans.
December 1, 1986	To The Industry, Procedure KC-ECC-1, Revision 1. Notice of revised procedures for exchanging commodity certificates for CCC-owned inventory.

December 4, 1986	Press Release 1499-86. Cotton specific commodity certificates issued August 1, 1986, and any generic certificates regardless when issued, may be exchanged for upland cotton in CCC inventory beginning January 2, 1987. Other cotton-specific commodity certificates may be exchanged for upland cotton in CCC inventory beginning five months from the last day of the month in which such certificates were issued.
December 16, 1986	Notice LP-1106. Authorization extended to County Offices to sell forfeited loan collateral to storing warehousemen in exchange for commodity certificates.
January 2, 1987	To The Industry, Procedure KC-ECC-1, Revision 1, Amendment 1. Procedures for exchanging commodity certificates for CCC-owned upland cotton. This amendment adds to Paragraph XII of Procedure KC-ECC-1, Revision 1, dated December 1, 1986. Cotton procedures were not included in the earlier document.
January 5, 1987	Press Release 11-87. Saudi Arabia eligible for more barley sales under the Export Enhancement Program to be subsidized with commodity certificates.
January 7, 1987	Notice LP-1108. Producers earning certificates from 1987 advance payments may use those certificates to redeem loan collateral. Loan collateral shall be valued on the day of loan redemption. Producers are not allowed to call County Offices to lock in certificate values.
January 7, 1987	Notice CN-716. Cotton sold or redeemed from CCC loan with cash during a period when the adjusted world price (AWP) is equal to or above 44 cents per pound is ineligible for first handler certificate payments. The AWP has been above 44 cents per pound from December 12, 1986, through January 8, 1987.

January 7, 1987	Press Release 20-87. Iraq and Poland eligible for sales under the Export Enhancement Program to be subsidized with commodity certificates.
January 13, 1987	Press Release 42-87. Successful offerors given more time to exchange cotton certificates.
January 29, 1987	Notice LP-1113. For producers entering into a marketing agreement covering the current year's crop that provides for transfer of title upon delivery, the applicable commodity becomes ineligible for price support immediately upon delivery, even if title is returned to the producer.
February 2, 1987	Press Release 112-87. Final deficiency payments to 1986-crop rice producers to be paid in cash.
February 2, 1987	Press Release 114-87. Final deficiency payments to 1986-crop upland cotton producers to be paid in cash.
March 13, 1987	Press Release 299-87. Expiration dates on upland cotton commodity certificates extended because of a shortage of CCC inventory available for exchange. All current outstanding and all new upland cotton certificates issued under the 1986 upland cotton program will have an expiration date of either February 29, 1988 or 9 months from the last day of the month in which the certificate is issued, whichever is later.
April 6, 1987	Press Release 398-87. Original holders of generic commodity certificates that expired December 31, 1986, through March 31, 1987, may request that the certificates be exchanged for cash. ASCS county committees may authorize payment for expired certificates equal to the face value minus 15 percent for handling and another 4.3 percent required by the Balanced Budget and Emergency Deficit Control Act of 1985.

The CHAIRMAN. Thank you very much for being here.

Our next panel will be Keith Hora, first vice president, National Corn Growers Association; Duncan Russell, grain marketing manager, The Andersons, Maumee, Ohio; and Jim Moseley, a farmer from Clarks Hill, Indiana.

Would you all come up and make yourself comfortable? We have a fourth person for the panel—Mr. Larry Johnson has been added to the panel.

The testimony that preceded you is one of such clarity that many of the people who might have been here to ask questions earlier are not.

Who on the panel would like to begin?

The time will be divided equally among the panel members. I only mention that so that those who are around you will then bring greater pressure on you to keep within the time because they know it is coming out of theirs. I do not want to put any pressure on you by mentioning this.

STATEMENT OF KEITH HORA, FIRST VICE PRESIDENT, NATIONAL CORN GROWERS ASSOCIATION, ACCOMPANIED BY LARRY JOHNSON, CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE

Mr. HORA. Thank you, Mr. Chairman.[1]

We are extremely pleased to have the opportunity to testify before you today and express our association's views and positions about generic certificates for payment to farmers and for farm program benefits.

I am Keith Hora, first vice president of the National Corn Growers. I am a corn farmer from Riverside, Iowa. Along with me today is Larry Johnson. He is chairman of our Government Affairs Committee. He is also a corn farmer from Cologne, Minnesota.

The CHAIRMAN. We know Mr. Johnson very well, and he is always welcome in this committee.

Mr. HORA. Very good.

And as you noticed, as we come on the panel, our two Senators both leave.

The CHAIRMAN. But in their defense, they have already asked me to tell them exactly what you have said.

Mr. HORA. Very good. I would be happy to answer their questions whenever that opportunity arises.

Members of our organization have heard on numerous occasions that we are not supportive of the generic certificates as a means of Government payment for farm program benefits. But let me assure you and this committee that our organization does indeed support the generic certificate program. As a matter of fact, I would like to clearly state the position of the National Corn Growers Association that was adopted at our 1986 annual convention: "All Government program payments should be made payable to the farmers in the form of PIK certificates with no dollar limitations."

That is a quote directly from our policy.

Our position on the generic certificate program, I would also like to say, now that we have cleared that up, our position on the ge-

[1] See p. 112 for the prepared statement of Mr. Hora.

neric certificate program, we would like to discuss some additional aspects of the use of generic certificates and what they can and cannot do for our corn farmers.

First I want you to know that our organization is just as committed to the implementation of the marketing loan for U.S. corn. As we all know, the Food Security Act of 1985 gives the Secretary of Agriculture discretionary authority to implement the marketing loan.

As of this date, the Secretary has not implemented the loan for corn as provided in the 1985 farm bill. He argues that the loan rate reductions for corn under the Findley amendment are keeping U.S. corn prices competitive in the international market with corn from other origins. In addition, the Secretary also argues that the use of the generic certificates is having the same effect or having the flavor of the marketing loan. But I think we heard earlier Secretary Amstutz saying that they are trying to blend this actual use of the Findley amendment on loan rates along with the amount of certificates that are available plus the difference in the posted county price to maybe prevent this market from going too low. Our organization is having some problem with that philosophy, because we were told when we first passed the 1985 farm bill that really, in a sense, this was an experiment whereby we were going to bring loan rates down to market clearing levels so that we could have greater access to the world market. With the implementation of the marketing loan, we could go ahead and bring them down even further and find out, as Secretary Amstutz said, so to speak, we could have a fire sale or there is no better cure for low prices than low prices. I agree with him 100 percent. That is exactly right. That is what we could do.

But I cannot understand why we make that statement and then we turn around and say we do not want a marketing loan because it costs too much. If you really understand the true economic aspects of it, as the prices go lower, granted it might cost the Government more money for a few months, but within 6 months that market price would be high enough we may even have the market prices back to where loan rates are. That is entirely possible.

I just want to go on and tell you our organization is confronted between the choice of having either generic certificates or the marketing loan. I would say we would have to consistently say that these two programs are not mutually exclusive and could well be operated simultaneously just as the two programs are for cotton and rice.

Moreover, if our organization is asked to choose between generic certificates and the marketing loan, we would urge that the marketing loan be implemented immediately as opposed to continuing the use of generic certificates in that program. In this regard, Larry Johnson, our vice president for Government relations, will point out some of the disadvantages of the generic certificate program.

Mr. JOHNSON. Thank you, Keith.

I will not read this. You all have it in front of you. I would like to address three things specifically. One is the lack of consistency in our policy that came about by the certificate program, and also

the workload both at the local offices and the time wasted by the farmers.

Unless you have been out there, I do not think anybody can comprehend what is happening in these local offices. They are so burdened with paperwork, we have just gotten our second half wheat deficiency payments 3 months late. The 10 percent deficiency payment will take at least 6 weeks after the okay is given to release it. It is just impossible to try and plan a program. If you have got any appeal basis, it takes forever to get that done.

It is just collapsing under its own weight. And the farmers are in line to go in there. I am in a dairy area. I am lucky I can get in there at 8 o'clock in the morning, most of them cannot. From 10 until 2, you are waiting 6, 7, 8, or 10 in line.

It is frustrating to the farmers and to the people working in there alike.

In regard to the lack of consistency on it, the statement says that there is a continuing concern that the Department of Agriculture may issue certificates in such a fashion and in conjunction with further changes in rules to PIK and Roll simply to maintain a predetermined trading value of the generic certificate.

An objective like that, we cannot judge as to what it might be. We have seen the county basis price formula be adjusted by combining different locations.

We have just heard Mr. Amstutz say that to try and control this is more art than science. We are trying to get away from that. That puts the control as to how artistic the manipulator would be. It makes it very difficult for us out in the country to understand what is going to be coming next and how to plan our operations.

These are a few of the things that I see from out in the country that I would like to bring to your attention.

Mr. HORA. I would like to make one more comment. In some of the earlier testimony the questions arose because of the certificate program there were more loans being made. In other words, say, "a livestock farmer who normally would not take out a loan on his corn was doing so because of the advantages of the certificate program." But is not that kind of a fallacy also? The only way you can get a loan is to participate in the Government program. Now, is it not the goal of this program and this administration to get all farmers to participate in the program so that we have the 20 percent reduction in acreage? That was never brought out either.

Do acreage reduction programs work or do they not? I think that is another question that needs to be addressed as you look at the whole scenario of the PIK certificates and additional cost of loans.

I would like to conclude by saying that our organization continues to support the use of generic certificates, albeit with some reservations and some concerns about the cumbersome method of operations, as Larry pointed out, of that program. But again, we want to stress that our support for the generic certificate program is only second to our commitment to having the marketing loan implemented for corn.

Mr. Chairman, I want to thank you. We would be happy to answer any questions.

The CHAIRMAN. Thank you.

Without objection, we will insert the statement of Mr. Hora into the record.

We will get the testimony from the remaining witnesses before opening it up for questions. Mr. Russell.

STATEMENT OF DUNCAN RUSSELL, GRAIN MARKETING MANAGER, THE ANDERSONS, MAUMEE, OH, REPRESENTING NATIONAL GRAIN AND FEED ASSOCIATION

Mr. RUSSELL. Thank you very much, Mr. Chairman.

My name is Duncan Russell. I am the grain marketing manager for The Andersons in Maumee, Ohio. I am here on behalf of the National Grain and Feed Association, representing 1,200 member companies.[1]

The members of the National Grain and Feed appreciate this opportunity to discuss the generic certificate program with you. We strongly support the continuation of the generic certificate program because of the positive role it has played in restoring competitiveness to U.S. grain.

First, some background: through the end of 1985 our U.S. farm program provided a price support umbrella for nations competing with the United States in export grain trade. Our competitors often priced their commodities just below the U.S. price support umbrella. They expanded production in the face of declining demand, grabbing U.S. market share, working to liquidate their stocks, forcing the United States to accumulate and store the excess.

Consider that world coarse grain trade in 1980–81 was at 118 million metric tons. It declined to 96 million metric tons in crop-year 1985–86, or an 18 percent decline. U.S. exports declined 47 percent over that same period. U.S. carryover stocks increased from 42 percent of world total in 1980–81 to 73 percent in 1985–86. The message was clear. The United States was not price competitive, and our high price supporting loan program was the primary reason.

The situation became increasingly painful for the United States and, more particularly, our agricultural sector. Our Government responded to this strategically important issue. Congress and the administration are to be commended for the Food Security Act of 1985. The act was designed to reduce loan levels in the hopes of restoring U.S. competitiveness while continuing to provide a financial safety net for U.S. producers.

The positive effects of the new farm bill are only beginning to crystallize. One of the most significant and positive components is what has become known as the generic certificate program. It provides a mechanism for prices to fall below the legislatively mandated loan rates to levels competitive internationally. For fungible commodities such as grain, there is an indisputable direct correlation between price and demand. As prices decrease, demand increases. We are beginning to see the evidence of this truth.

With this as background, I would like to——

The CHAIRMAN. Are you seeing it in exports?

Mr. RUSSELL. I believe so.

The CHAIRMAN. How much?

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[1]See p. 115 for the prepared statement of Mr. Russell.

Mr. RUSSELL. I believe that the recent purchase of approximately 4 million tons of corn by the Soviet Union is an example of our price competitiveness. Without——

The CHAIRMAN. Is it because of price competitiveness or are there other foreign policy considerations there?

Mr. RUSSELL. I believe personally that it is primarily from a price competitiveness standpoint. That is my opinion. I do not believe that without price competitive corn in international markets we would have done that business.

The CHAIRMAN. Go ahead.

Mr. RUSSELL. Thank you.

With this as background, I would like to focus on generic certificates, concentrating on the pros and cons of the program.

Clearly, certificates are not a panacea for U.S. agriculture or for the U.S. Government. However, it is the most effective program in the USDA's arsenal for allowing grain prices to reach competitive levels in world markets. It is critically important that the generic certificate program be maintained or expanded to allow the competitive mechanism to work.

We believe it would be a strategic mistake to abandon or scale back the generic program.

There are several reasons why the generic program has been successful.

First, generics encourage loan redemption, thus creating free stocks. This decreases loan forfeitures to the CCC, should reduce foreign production incentives, and increase the demand for U.S. coarse grains and wheat.

U.S. prices have been more competitive recently. As I mentioned, we have recently done about 4 million metric tons of corn business with the Soviet Union. I do not believe without a competitive price structure this business would have been done.

In all likelihood, this 4 million metric tons of grain would have ended up in CCC inventories. The annual cost of storing that inventory would have been approximately $50 or $60 million.

U.S. domestic consumption of corn is up as well. In response to lower prices, we are seeing increased feed and processing use. In 1986-87 domestic consumption will be 250 to 300 million bushels higher than a year ago. Again, this is grain that probably would have moved into the CCC inventory without low prices. The annual cost of carrying that grain is estimated at $125 million.

Second, generics provide a new marketing alternative for producers. They now have a PIK and Roll alternative to liquidate price support loans. This creates free stocks in order to satisfy consumptive demand and also can have a price depressing effect that will serve to stimulate demand.

Third, commodity certificates provide a mechanism through which CCC stocks can be acquired competitively in the marketplace.

Under our historical price support program, CCC stocks were isolated from the market and not available except at a significantly higher price. As a result, stocks once forfeited to the CCC were likely to stay there for extended periods. During the last 12 months in excess of 250 million bushels of CCC-owned commodities were re-

deemed by the market. The annual savings to the Government of not having to inventory this grain is $125 million.

Fourth, generics provide a tool to alleviate storage congestion and the need for the Government to pay for the relocation of grain. This has been touched on earlier today.

We estimate that, were it not for the generic program, CCC would have probably spent on the order of $750 million reconcentrating 1 billion bushels of grain over the last 12 months.

In summary, the dominant issue here is one of allowing American farmers to compete in world markets. Exports are beginning to increase. We see evidence that our competitors are recognizing the renewed competitive posture in international markets.

Mr. Chairman, we maintain that if all of the short- and long-term benefits of generics are considered, they outweigh the costs. We simply must be competitive in world markets if we are to have a healthy agricultural economy.

Thank you for your time.

The CHAIRMAN. Thank you.

Even though the time of the panel has been taken up and the hearing has run half an hour late, Mr. Moseley, I am not going to have you come all the way from Clarks Hill, Indiana, and not have a chance to testify. So, I will use the prerogative of the Chair to give you the time to testify. Please do so, sir.

STATEMENT OF JAMES MOSELEY, CLARKS HILL, IN

Mr. MOSELEY. I appreciate that, Mr. Chairman.[1]

I have been asked to explain the use of generic payment-in-kind certificates as they relate to a grain and livestock farm. Since the beginning of the certificate idea 1 year ago, we have used certs in four different ways in our operation. First, as PIK certificates——

The CHAIRMAN. Would you describe what your own farm is like?

Mr. MOSELEY. Sure. We have a 2,300-acre farm and 7,500 head of hogs that we raise per year.

The CHAIRMAN. Go ahead.

Mr. MOSELEY. As PIK certificates became available from a deficiency payment, we sold them for cash. Of course, there is a very liquid market available every day for that at our local grain market.

Second, certificates received from deficiency payments have been used to redeem corn for feed in our hog operation.

Third, because we do not receive enough PIK certificates through the deficiency payments to redeem all of our feed needs, we have bought certificates recently at a premium to their face value.

The CHAIRMAN. Let me ask you two questions. You bought PIK certificates recently and at a premium. How much of a premium? By recently do you mean the last few weeks?

Mr. MOSELEY. In the last month and a half we have bought certificates.

The CHAIRMAN. The last month and a half. How much of a premium are you generally running on your PIK certificates? I find this premium phenomenon on PIK certificates to be fascinating.

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[1]See p. 122 for the prepared statement of Mr. Moseley.

Mr. MOSELEY. 108 percent on the last group that we bought. And we rationalize that we can pay 110 percent just from transportation charges in and out of our farm. In other words, if we had the corn under loan and decided to forfeit, we would have to transport it out to a CCC delivery point, and we would have to transport corn in to feed our animals. That is 18 cents. We figure that the generic certificate maintains a base value for us of about 110 percent, and 108 percent, we thought, was a real bargain. I bought a lot of them. I am in long, the generic certificate, right now, and they are worth about 106.5 percent. So, you know, I took a speculative position at what I thought was a good deal and now is not quite so good.

The CHAIRMAN. Have you bought PIK certificates at a premium in the past?

Mr. MOSELEY. That was the first group of certificates and we bought a large number of them because of their value. No, we have not had to buy certificates up to that point in time.

The CHAIRMAN. Continue please.

Mr. MOSELEY. Finally, because we need our farm storage empty for harvest next fall, we have decided to sell all the corn over our feed needs. The method used is contracting the corn for delivery at a price, buying the certificates, as we have already done, and then finally redeeming the corn from loan and delivering it to the elevator.

In my prepared statement, page 2, the examples point out the flexibility the certificate has given us to manage our grain inventory. The important point is these options are available to all farmers regardless of size of operation. As has been reported here by Senator Boschwitz, a week ago a young man in our area came to me with a proposal. He is trying to start farming. He wanted to rent a farm of about 300 acres, but he had no grain storage on it. It was going to cost him $23 an acre to rent storage. However, if I would agree to lease him a grain bin on a very short-term basis, 1 to 2 weeks, he had figured he could PIK and Roll during harvest. Now, what this means is, he could contract the corn for fall delivery, obtain PIK certificates from his deficiency payments plus some additional purchase, put the corn under loan at harvest, immediately redeem that with his PIK certificates and deliver the corn into the marketplace. That emptied the bin, and I could then go ahead and use the bin for our needs.

He believed he could save the $23 per acre, and that was the difference that he needed to rent the farm. And I am happy to say that that young man will be farming this next year.

The CHAIRMAN. In my State, Vermont, farming has become less and less a part of the economy. We have 2,700 to 2,800 farms plus my tree farm.

We have become very much a high technology State. IBM makes their new chips there, and hired 8,000 or 9,000 people to do that. Digital, General Electric, and others do the same. I am beginning to think that we had better teach Vermonters how to create computer programs to handle your PIK and Roll programs out in Indiana. I think that will be the new market at home.

What this young man has done who wants to farm the 300 acres is fascinating. Is that typical?

Mr. MOSELEY. He is very proficient with the use of the computer, but I do not think he really needed that device.

The CHAIRMAN. Would you say that the sort of thing he is doing is typical?

Mr. MOSELEY. Yes, it is——

The CHAIRMAN. He is not unusual?

Mr. MOSELEY. Yes, it is a typical practice for those who have taken the time to understand it. I think that gets me to my next point.

There has been some criticism about certificates because they are difficult to understand. This has some foundation. It took some study on my part when they were first introduced, however, we learned quickly because they are part of our business. Almost immediately the ASCS offices, the farm media, the grain trade, and agricultural schools in our land grant system began to make good information available on how to use the certificate. There really should be little reason for a farmer not to know how to use the certificate based on lack of information.

I was going to make the point about the Dakota shuffle. I guess I can abbreviate that. It has been talked about quite a bit today. Just leave it to say that I think it was an unfortunate event that happened. It probably gave the certificate a bad name when it was not really the certificate's fault. We have to recognize that there was another problem there and that the certificate was only the mechanism and make sure we lay the blame at the right place.

I have to applaud USDA for catching the problem and dealing with it in a swift and what I think was a very fair and just way.

The last thing I want to address is the ability of the American farmer to compete. It seems that we currently have three alternatives on the continuum as we look at the alternatives we have available. At one end is the loan program with a fixed price. At the other end is the potential marketing loan that has been discussed quite a bit here today. The ability to use generic PIK certificates seems to me is a compromise that falls someplace in the middle.

Unfortunately, the fixed loan is more of the same, a medicine that we have experienced in the past. If the market price of corn, for example, is under the loan, then there is no mechanism to allow grain into the market until the loan rate is reached.

A marketing loan, on the other hand, would do the most in the least time to improve our competitive edge. Prices would drop significantly to market clearing levels, and demand would increase significantly, I believe. Government budget exposure, though, would increase. In this budget-conscious time, I think we would politically have a problem.

I strongly support the idea but I do not know that it is necessarily doable.

The PIK certificate seems to be a middle road that accomplishes some of the desirable characteristics of a marketing loan.

With respect to cost, it seems that we must accept the pay now or pay later philosophy. If we restrict the flow of grain via a rigid loan program, the costs to Government for storage must accumulate at a rate that exceeds at least 35 cents per bushel per year. I would note that that is my estimate, and I am understanding from

people within the Government circles that that figure is indeed higher than that.

With the PIK certificate, some of this grain will be forced into the market instead of a grain bin. This must offset considerably Government costs. That is a feeling. I have heard some testimony today to document and back that up, but that is a farmer's feeling.

One final comment before I summarize. I think we must be certain in this discussion that we differentiate the solution from the problem. As I see it, the generic certificate is only the symptomatic relief for the real problem, the continued oversupply of grain. A good analogy would be that it is the Vicks cure for the common cold. We must keep pneumonia from occurring by sending the correct signals to farmers domestically and internationally. A couple of things that I think that need to be considered: a 0-92 proposal would make some sense for consideration for 1988. Secondly, an acceleration in the reduction of target price would be in order. The reason for that is we have seen additional declines in production cost above what our expectations were over the past 2 years. I anticipate that to continue.

Finally, and most important, we must send a price message to the world that strongly suggests we will not tolerate continued expansion and indeed perhaps help liquidation or at least contraction of world acreage. A certificate PIK will help send this signal by lowering prices of commodities available to the market.

To summarize, I continue to support the use of generic PIK certificates. They provide a service to the industry to keep a supply of grain available at a cost that is likely comparable to storing forfeited grain for several years. They can relieve the storage problem in deficient areas because they are much easier to mail several hundred miles than to ship the commodity. They are easily negotiable and provide liquidity for the market. Finally, certificates help send a message to the world.

Certainly, the system they work in could be improved. For example, as a farmer, it would be helpful to me if I knew how many and in particular when additional certificates would be delivered.

We also need to make certain that the differentials between terminal markets are smoothed out to assure equal opportunity to different geographical areas. Except for the need, though, to make some minor adjustments in the system, they are working just fine.

Thank you.

The CHAIRMAN. Thank you very much.

Gentlemen, I thank you all for being here.

I will keep the record open for other Senators who may have questions.

The Agriculture Committee began its questioning of the PIK program by assuming that it was very complicated. You have enabled us to be secure in our knowledge that it is indeed very complicated. Now perhaps the PIK certificate program, which will be under attack by some this year, will be determined as much on its complexity and its ability to obfuscate the real issues as it will on its efficacy in improving the farm situation.

In any event, you have been helpful today. I suspect that this is a matter that will be examined a number of times by this committee this year.

Thank you very much.

We stand adjourned.

[Whereupon, at 4:45 p.m., the committee was adjourned, subject to the call of the Chair.]

APPENDIX

STATEMENT OF HON. JESSE HELMS, A U.S. SENATOR FROM NORTH CAROLINA

Mr. Chairman, thank you for following up on this important issue. The PIK certificate substitution practice, or PIK-and-Roll as many called it, was one of the worst abuses of farm programs I had seen in many years. It hurt farmers and taxpayers alike. This hearing should help in identifying who profited from PIK-and-Roll, and what congressional action should be taken to ensure the practice does not reoccur.

On November 12, 1986, I asked the General Accounting Office to conduct an investigation of the use of generic payment-in-kind certificates by agricultural producers and grain trading companies. I asked that they pay special attention to the PIK-and-Roll practice.

PIK-and-Roll was a complicated practice by which grain from lower market price areas was substituted for grain in higher price areas, then redeemed for PIK certificates. Since PIK certificates were denominated in dollars rather than bushels, grain handlers were able to profit from the difference in market prices because PIK certificates could be used to purchase a larger quantity of grain in low-price areas.

I've said it over and over again. This was just another example of how too much of the taxpayers' money is going to big, rich operations at the expense of the family farmers who need the help. We continue to pour billions of tax dollars into farm programs in an indiscriminate manner. If we are to help the family farmer and those farmers in need, Congress must better target the vast sums of money being spent in agriculture.

STATEMENT OF BRIAN P. CROWLEY, SENIOR ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Committee, we are pleased to be here today to discuss certain aspects of the U.S. Department of Agriculture's (USDA's) use of commodity certificates. Certificates are negotiable documents issued by USDA's Commodity Credit Corporation (CCC) in lieu of cash payments under certain commodity price-support and export promotion programs. They are issued in dollar denominations, and, with certain exceptions, they are "generic" in that they can be exchanged for any commodity under loan to, or owned by, CCC.

We focused our work on commodity certificates primarily on the costs to the government of issuing certificates instead of cash payments. However, because these costs depend in part on how the certificates are used, we also analyzed why certificates have been used as they have been by farmers and grain companies. As I will explain, certificate use is driven largely by the benefits they confer on the users. In addition, we looked into why certificates have traded for premiums—that is, prices exceeding their face value.

Mr. Chairman, before getting into the results of our analysis, I think it would be helpful to briefly discuss the background of certificates.

CERTIFICATES AND THEIR USE

The Food Security Act of 1985 (P.L. 99-198) provided the Secretary of Agriculture with statutory authority to issue negotiable commodity certificates to make in-kind payments to eligible farmers who choose to participate in certain government price- and income-support programs and to companies that participate in USDA's export promotion programs. The Secretary used this authority to issue commodity certificates for a portion of CCC's program payments to both farmers and companies. For example, instead of receiving $1,000 in cash, a farmer receives a certificate with a face value of $1,000, which the farmer can exchange for $1,000 worth of commod-

ities. The exchange prices of the commodities, referred to as posted county prices, or PCPs, are set by CCC on the basis of observed market prices.

Between April 1986, when certificates were first issued, and January 1987, CCC issued about $5.5 billion in certificates. Of this amount, about $4.1 billion represents price deficiency and land diversion payments to farmers participating in CCC's price- and income-support programs. Through February 1987, about $3 billion have been exchanged and the remainder are outstanding.

Farmers who receive certificates may exchange them for their crops under price-support loans, or, after a certain waiting period, exchange them for cash from CCC. Farmers may also sell their certificates to other farmers, grain companies, or any other interested buyers. Grain companies may in turn resell the certificates, or may exchange them for commodities owned by CCC.

CERTIFICATES WILL INCREASE CCC PRICE-SUPPORT LOAN OUTLAYS

The cost of certificates depends primarily on how the certificates are used, which in turn depends on existing market conditions. Although certificates can affect the budget in several ways, their greatest impact is on price-support loan outlays.

Consequently, we focused our effort on quantifying the effect of certificates on net loan outlays. Net loan outlays are a measure of the dollars loaned to farmers less the cash repayments made to CCC. We estimate that the $3 billion in certificates exchanged through February 1987 will increase CCC's net loan outlays by about $3.09 billion to $3.64 billion. Compared with the approximately $2.98 billion in cash program payment outlays that were avoided by issuing these certificates, this is a net increase in total CCC outlays of about $107 million to $653 million.

However, this increase will be offset to some extent by short-run commodity storage cost savings to CCC. While these are difficult to quantify, we estimate that these savings could be from about $169 million to $253 million. I will discuss the basis for these estimates later in my testimony.

Why loan outlays will increase

When certificates are issued, government expenditures are not initially affected because certificates, unlike cash payments, are not treated as budgetary expenditures. However, when certificates are exchanged for commodities, outlays for CCC's price-support loans ultimately rise. We estimate that this rise in loan outlays will exceed the reduction achieved in issuing certificates.

The rise in loan outlays happens for two basic reasons. First, net loan outlays rise directly as farmers place under loan, and then immediately exchange certificates for, crops that they would otherwise not have placed under loan. They use certificates in this way to benefit from the price-support loan program without having to incur the storage costs usually associated with that program. This increases net loan outlays.

Second, net loan outlays rise indirectly when farmers exchange certificates for loan commodities that they otherwise would have forfeited, or when grain companies exchange certificates for CCC-owned inventory. These uses of certificates tend to increase the supply of commodities in the marketplace. These increased supplies may cause commodity prices to decline; this effect has been most obvious to corn. Price declines, in turn, induce some farmers to obtain loans they would otherwise not have made or to forfeit commodities under loans that they would otherwise have repaid in cash. This also increases net loan outlays.

Available data do not permit exact measurement of the increase in CCC's net loans due to certificates. Our estimates are based on available data about market conditions, certificate use to date, and estimates about how the demand for certain commodities responds to price changes. In general, net loan outlays will rise more when market prices for some crops are well below their loan rates, as they are today, than when all market prices are at or above loan rates. If conditions change (for example, if corn export demand were to increase, raising corn prices), the cost effects of certificates used in the future could be smaller.

Factors that work to offset increased net loan outlays

While certificate use has increased outlays for the loan program, certificates will reduce CCC's short-run storage costs and may have helped avoid some transportation costs.

Certificates may have helped ease the Corn Belt storage crunch that USDA expected for the fall 1986 harvest. Farmers had a financial incentive to exchange certificates for corn that otherwise would have been forfeited to CCC. Because commercial storage in the Corn Belt was limited at that time, CCC may have transported

forfeited corn to parts of the country where storage was available. However, because it is difficult to estimate just how much transportation would have occurred, it is difficult to quantify the savings.

Certificates reduce short-run storage costs when they are exchanged for CCC-owned inventory, for farmer-owned reserve loan collateral, or regular loan collateral that farmers would otherwise have forfeited to CCC. While we estimate that inventory reductions resulting from these certificate uses will ultimately be offset by an equal or almost equal amount of forfeited grain, there may be a span of several months between the exchanges and the certificate-induced forfeitures.

Storage cost savings are difficult to quantify because we do not know what this average time span may be. We also do not know how long CCC-owned commodities exchanged for certificates would have remained in CCC inventory in the absence of certificates. Assuming that about 6 months storage was avoided, we estimate savings of about $169 million; assuming 9 months of avoided storage raises this estimate to about $253 million. However, the actual storage savings could be more or less than these amounts.

CCC's future storage costs will be reduced only if, in the long run, certificates ultimately reduce CCC-owned inventory. We believe that such a reduction, if it occurs, will not be large. This is because we believe that the quantity of CCC-owned inventory exchanged for certificates will not be much greater than the additional quantity that will ultimately be forfeited to CCC as a result of certificates. Certificates are likely to cause a significant inventory reduction only if they decrease commodity prices enough to stimulate more consumption. There is some evidence that certificate use has led to lower corn prices; however, the effect of certificates on other commodity prices is not clear.

Why outlay effects may be delayed

In addition to affecting the size of budget outlays, certificates may also affect their timing. Substitution of certificates for cash payments can shift outlays from one year to the next. This is because certificates, issued instead of cash payments, cause current-year outlays to be lower than they would have been otherwise. However, increased loan outlays attributable to the certifcates may not occur until much later. Two factors account for this delay.

First, certificates are not always used immediately after they are issued. Most of the offsetting increase in loan outlays will not occur before the certificates are exchanged. If certificates are not exchanged until the fiscal year after they are issued, then most of the increase in net loan outlays will occur in the following year, not the year of issuance. In this way, total outlays will be shifted from one year to the next.

Second, there may be a timelag between the increased quantity of commodities brought on the market by certificate exchanges and a resulting decline in the market price. Additional time may pass before farmers respond to lower prices by obtaining loans that they would otherwise not have obtained, or by forfeiting loans they would otherwise have repaid in cash.

POTENTIAL BUDGETARY CONTROL ISSUE

Under current budgetary reporting procedures, certificate amounts are not included in the budget's outlay totals at the time of issuance, even though they ultimately have effects similar to outlays. This may lessen the usefulness of the budget and its reported outlay amounts to the Congress in its budget-related deliberations and actions. The proper budget treatment of certificates is a complex and technical matter, but one that the Congress may wish to study further.

HOW FARMERS BENEFIT FROM COMMODITY CERTIFICATES

When farmers obtain price-support loans from CCC, they are obligated to store the loan collateral, at their expense, during the loan term, which can be up to 9 months. The cost of storing the crops in effect reduces the farmers' financial return from the loan program. For example, a farmer who obtains a loan of $1.84 for each bushel of corn would not realize a return of $1.84 per bushel if he or she forfeits the corn at the end of 9 months; the return would be $1.84 per bushel minus the cost of storage.

Certificates change this situation. Specifically, eligible farmers can now take out price-support loans and immediately exchange certificates for the loan crops at posted county prices. In this way, farmers obtain the full return from the loan program because they avoid the storage costs.

Certificates also give farmers more flexibility in marketing their crops. After benefiting from the loan program, farmers may temporarily keep their crops to take advantage of possible price increases. Farmers doing this of course risk a price decline. In addition, farmers who exchange certificates for their price-support loan collateral may also profit by marketing their crops at prices higher than the exchange prices established by CCC. While it attempts to set these prices to reflect market prices, CCC occasionally sets these values below actual market prices.

Finally, some farmers have enhanced their incomes by selling their certificates at premiums to other farmers or grain companies.

HOW GRAIN COMPANIES BENEFIT FROM CERTIFICATES

Certificates have given the grain industry greater access to CCC-owned grain at market prices. Thus, grain can be more readily obtained when and where needed. Certificates have also enabled grain companies, like farmers, to profit when they can exchange certificates for CCC-owned commodities that are worth more to them than the prices established by CCC.

Finally, grain companies may profit by serving as intermediaries in trading certificates. Several large grain companies told us that they actively buy and sell certificates. In addition to receiving commissions on purchase and sales transactions, according to the companies, they use certificates as marketing tools to bring grain business to their facilities.

Grain companies were reportedly involved in helping farmers take advantage of a specific CCC loan program provision. This provision allows farmers facing storage problems in their locality to obtain a loan, not on the crops they harvested locally, but on an equivalent quantity of the same crops located in a part of the country where storage is available in commercial facilities. In such cases, the farmer's grain is said to have been "substituted."

Because posted county prices vary among localities, some farmers could benefit more from certificates by first substituting their loan grain, then exchanging certificates for the grain. In some situations this practice was so profitable that farmers could buy certificates from grain companies at a substantial premium and still come out ahead financially. USDA ended this practice on October 31, 1986. We plan to issue a separate report on this matter later this year.

WHY CERTIFICATES HAVE TRADED AT PREMIUMS

As I stated earlier, some farmers as well as grain companies have been willing to purchase certificates at prices exceeding their face value. It is important to note that, in and of themselves, premiums paid for certificates do not cause government costs to increase.

As with other negotiable goods, the price at which certificates trade depends upon two factors: the supply of certificates available to be traded and the demand for certificates by farmers, grain companies, or other parties. The supply of certificates available for trade depends upon the amount CCC issues as well as the recipients' willingness to trade. Certificate demand—and the recipients' willingness to trade—is driven by the benefits they provide to farmers and the grain industry, as I have just outlined. Both the supply and demand for certificates can change over time. Because of the benefits certificates provide, farmers and others have been willing to buy them at premiums.

STATEMENT OF KEITH HORA, FIRST VICE PRESIDENT, NATIONAL CORN GROWERS ASSOCIATION

Mr. Chairman and committee members, we are extremely pleased to have the opportunity of testifying today before your committee, and to express our association's views and positions about generic certificates for payment to farmers for program benefits. I am Keith Hora, the first vice president of the National Corn Growers Association (NCGA). I am a corn farmer and agricultural producer from Riverside, Iowa. Accompanying me today is Larry Johnson, our chairman of the NCGA Government Affairs Committee, who is also a corn farmer from Cologne, Minnesota.

The National Corn Growers Association (NCGA) is make up of corn producers from 19 States, with the purpose of promoting the general welfare of U.S. corn growers by advocating domestic corn production and income support programs consistent with a market-oriented grain economy. NCGA member States include, Colorado, Georgia, Illinois, Indiana, Iowa Kansas, Kentucky, Maryland, Michigan, Min-

nesota, Missouri, Nebraska, North Carolina, Ohio, Pennsylvania, South Dakota, Tennessee, Virginia and Wisconsin.

Members of our organization have heard on numerous occasions that we are not supportive of the generic certificates as a means of Government payment for farm program benefits. Let me assure this committee that our organization does indeed support the Generic Certificate Program. As a matter of fact, I would like to clearly state the position of the national corn growers association that was adopted at our 1986 annual convention:

"All Government program payments should be made payable to the farmers in the form of PIK certificates with no dollar limitation."

Now that we have cleared up any misunderstanding about the NCGA position on the Generic Certificate Program, we would like to discuss some additional aspects of the use of generic certificates, and what they can—and cannot—do for American corn farmers.

Notwithstanding the NCGA position on supporting the use of generic certificates, our organization is just as committed to the implementation of the marketing loan for U.S. corn. For two consecutive annual conventions in 1985 and 1986, the voting delegates to our annual conventions have endorsed in "open ended, recourse marketing loan for corn" for many reasons. As we all know, the Food Security Act of 1985 gives the Secretary of Agriculture "discretionary authority" to implement the marketing loan—but restricts such implementation to a marketing loan that is "nonrecourse and with a floor of 70% of the loan rate."

As of the date, the Secretary of Agriculture has not implemented a marketing loan for corn as provided for in the 1985 farm bill. He argues that the loan rate reductions for corn under the Findley amendment are keeping U.S. corn prices competitive in the international market with corn from other origins. In addition, the Secretary of Agriculture also argues that the use of the generic certificates is having the same "effect" or having the "flavor" of the marketing loan. If this is the case, then our organization would request members of this committee to urge the Secretary of Agriculture to implement the marketing loan so that the full impact of the marketing loan would be manifested in the international market in pricing corn for export.

When our organization is confronted between the choice of having either generic certificates or the marketing loan, we have consistently argued that these two programs are not mutually exclusive and could be operated simultaneously as the two programs are for cotton and rice. Moreover, if our organization is asked to choose between generic certificates and the marketing loan, we would urge that the marketing loan be implemented immediately as opposed to continuing the use of the Generic Certificate Program. In this regard, let me point out some of the disadvantages of the Generic Certificate Program as it is now being operated as opposed to the advantages of having the marketing loan in place.

Generic certificates.—If the Department of Agriculture would issue the fullest amount of certificates and use a consistent and understandable county basis price formula, the generic certificate might come closer to having the "effect" of the marketing loan. Many farmers are confused because of the complexities of the Generic Certificate Program. There is a continuing concern that the Department of Agriculture may issue certificates in such a fashion and in conjunction with further changes in rules for "PIK-and-Roll" simply to maintain a predetermined trading value for the generic certificate. In addition, the use of the generic certificate is hampered by a complicated redemption process that is really placing an ordinate workload on both farmers and county offices of the Agricultural Stabilization and Conservation Service (ASCS). And in this regard, let me just set out the major steps that a corn farmer must take, in conjunction with county ASCS offices, to redeem loan corn under the Certificate Program. In addition, this process requires the use of at least 10 separate forms for the certificate redemption of loan corn:

Application at the ASCS office for the certificate.

Lien search and financial statement submitted to ASCS office.

Lien waiver from both the landlord and/or bank for submission to the ASCS office.

ASCS preparation of the promissory note and security agreement.

ASCS office check-off on corn in those States having corn check-off programs for market development and other activities.

Preparation of the loan document for farmer signature.

Preparation of the check for payment to farmer.

ASCS office measures corn in storage bin to assure quantity and obtain sample of the corn to assure quality and grade.

ASCS office issues loan check to the farmer.

Farmer redemption of the loan with the submission of the certificate.

ASCS office provides and the farmer acknowledges the price of corn at which the certificate is used for redemption.

Each certificate, regardless of the amount, must be calculated at the county basis price for redemption.

ASCS office prepares farmer repayment record for ASCS files.

All of the above steps and necessary forms are then entered into the computerized ASCS system.

Along with the above step-by-step walk-through of the cumbersome certificate process, local ASCS county offices are also under undue prevailing pressure to calculate the final payment for the deficiency payment under the 1986 program as well as meeting the heavy workload of concluding farmer sign-up for the 1987 program—which ends on March 27, 1987.

The average time for a farmer to begin and complete this process with an ASCS county office can range from a low of three-to-four days to as long as two-to-three weeks for several reasons, not the least of which is the need to measure individual on-farm storage bins and to assure financial stability of each farmer in each certificate transaction. Nevertheless, the Generic Certificate Program has freed up storage facilities during the winter of 1986 and 1987; has allowed farmers to redeem loan corn to keep an adequate supply in the pipeline; and, has benefited farmers when they have had an opportunity of marketing certificates at a premium to the face value of the certificate.

Marketing loan.—The implementation of the marketing loan for corn would accomplish all of the "effect" or "flavor" of the Generic Certificate Program, but without many of the burdensome processes of the Generic Certificate Program. If the marketing loan were to be implemented for corn and use an aggregate weekly international grain price formulation for its calculation, as is being done for rice and cotton, several additional benefits would accrue to corn farmers and the Grain Marketing System:

U.S. corn exports would be priced for export at competitive levels for not only corn from other origins but also for foreign feed wheats that are displacing U.S. corn exports in various overseas markets.

U.S. corn prices would be at a level at which corn would be marketed in the export market without discriminating against domestic U.S. buyers of corn for feed and processor.

U.S. corn prices would be at a level for export trade that would negate any need for continuing the debate whether there should be an "Export Enhancement Program" for corn to selected overseas markets vis-a-vis the competitiveness of foreign feed wheats from other origins.

Conclusion.—Our organization continues to support the use of generic certificates, albeit with some reservations and concerns about the cumbersome method of operations of the program. But we want to stress that our support for the Generic Certificate Program is only second to our commitment to having the marketing loan implemented for corn. Our commitment to the marketing loan concept is best demonstrated by a quick review of the current condition of the U.S. corn economy.

Our corn exports have fallen from the 2.4 billion bushel volume in the 1979–80 and 1980–81 seasons to the USDA projected level of 1.1 billion bushels in 1986–87. In our view, the ultimate volume of corn exports in 1986–87 could well hit only the billion bushel level. Expressed another way, the 1986–87 corn export volume will fall to the low levels of exports in the beginning of the decade of the 1970's. During this same period of time, U.S. corn production has increased dramatically: from the 5.5 billion bushel volume in the early 1970's to the 8.0 billion-bushel-plus level in the mid-1980's. Current USDA carryout stock level projection best demonstrates the net results of the sharp fall-off of U.S. corn exports: corn carryout stocks as of September 30, 1987, are now forecast at 5.6 billion bushels. This level of corn carryout stocks far exceed the annual U.S. domestic utilization of corn—a carryout level rapidly approaching the combined volumes of both U.S. domestic utilization and exports.

The Secretary of Agriculture has refused to use the marketing loan authority for corn and grains because of several reasons, the most common of which is the projected cost for the marketing loan. We believe, however, that the marketing loan is not being used because it would be very effective in pricing U.S. corn and grain in the international marketplace in competition with grains from other countries. Consequently, departments other than the U.S. Department of Agriculture are prevailing within the Reagan administration to forgo the implementation of the "marketing loan" for foreign policy reasons—the same logic, only in reverse, that is used to

impose restrictions and embargoes on U.S. corn and grain exports for punitive foreign policy objectives.

While the authority in the Food Security Act of 1985 for the marketing loan languishes as an unused initiative, a "discretionary authority" for the Secretary of Agriculture, U.S. corn exports could well fall below the 1 billion bushel level for the first time since the 1971-72 season. The implementation of the marketing loan for corn would certainly make U.S. corn and grain exports price competitive with any grain export offer from any competing grain exporting country. Thus, the marketing loan would provide the efficiency, uncertainty and competitive edge for U.S. corn in the international marketplace that is now not present.

We would like to comment also that the Rice Millers' Association, in conjunction with Senators Pryor and Cochran, will release soon an economic analysis of the performance of the marketing loan for rice. While we look forward to seeing the entire study, we have been informed that one of the major conclusions of that study is "under the marketing loan, [rice] exports rise to 95 mil. cwt. by 1990/91, a 60 percent increase from the pre-marketing loan level of 59 mil. cwt. in 1985/86. This increases the U.S. share of world rice trade to the 1970's level of about 23 percent."

With respect to the marketing loan for corn and grain, we endorse and associate our organization with the statement on "marketing loan" by Wayne Boutwell, president of the National Council of Farmer Cooperatives, before your committee on March 18, 1987.

We appreciate having this opportunity to appear before you today, and will attempt to answer any questions that you may have about our testimony

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STATEMENT OF DUNCAN RUSSELL, GRAIN MARKETING MANAGER, THE ANDERSONS, REPRESENTING NATIONAL GRAIN AND FEED ASSOCIATION

Thank you, Mr. Chairman and members of the committee. My name is Duncan Russell and I am grain marketing manager of The Andersons in Maumee, Ohio. It is on behalf of the 1200 member companies of the National Grain and Feed Association representing country and terminal elevators, grain processors and exporters that I testify today.

The members of the National Grain and Feed Association appreciate this opportunity to discuss the generic certificate program. We strongly support the continuation of the generic certificate program because of the role it has played in restoring competitiveness to U.S. grain. However, before describing the many benefits of the generic program some macroeconomic background could be helpful.

The prices of U.S. farm production are just beginning to reach levels that are competitive in the international marketplace. And our new found competitiveness is having an impact.

Through the end of 1985 the U.S. farm program provided a price umbrella for nations competing with the U.S. in export grain trade. Our competitors generally priced their feed grains and wheat just below the United States in world markets and took away our business. In the face of declining overall export demand, their strategy was to stimulate their own grain production, and then liquidate their surpluses and force the U.S. to accumulate and store the excesses. We not only became the market of last resort, but we became the primary warehouse for much of the world's carryover stocks.

During the period from 1980-81 to 1985-86, while world coarse grain exports declined from 118 million metric tons to 96 million metric tons (an 18 percent decline), U.S. coarse grain exports declined from 70 million metric tons to 37 million metric tons (a 47 percent decline). At the same time, U.S. ending inventories of coarse grain stocks increased from 42 percent of the world's total stocks to 73 percent in 1985-86, an increase of 91 million metric tons.

World wheat exports declined moderately from 97 million metric tons in 1980-81 to 96 million metric tons in 1985-86. However, over the same period, U.S. wheat exports declined dramatically from 43 percent of world total to 26 percent of world total. At the same time, U.S. ending inventories of wheat increased from 34 percent of world stocks to 41 percent of world stocks, an increase of 24 million metric tons.

The message was clear, the United States was not competitive in world markets. Artificially inflated U.S. prices, as a result of high price support loan levels, was the primary causal factor.

The situation became increasingly painful for the United States and, more particularly, the agricultural sector of our economy. We were confronting an economic and policy crossroads which clearly had to be addressed or risk a continuous and permanent loss of our position in world markets. Our Federal Government is to be

commended for coming to grips with this strategically important issue. Our nation cannot afford to allow our agricultural sector to languish.

In response to this situation, Congress crafted and passed the Food Security Act of 1985. It was designed to reduce loan levels in the hopes of restoring U.S. competitiveness in world markets while, and at the same time, providing a continuation of the financial safety net for U.S. producers. As part of that legislation, the Secretary of Agriculture was authorized to issue commodity certificates.

The positive effects of the 1985 Food Security Act and its subsidiary programs are only beginning to crystallize. One of the most significant and positive steps taken was to provide a mechanism that would allow the prices of wheat and coarse grains to fall below legislatively mandated loan rates to levels competitive with other suppliers in the international marketplace. In terms of low cost, high volume, fungible commodities, there is an indisputable direct correlation between price and demand. Grain is no different—at lower prices, demand increases. The generic certificate program neutralized the effect of the coarse grain and wheat loan price support floor and has made our prices more competitive internationally. While the producers' interest is protected by price support levels and target prices, generic certificates permit access to supplies of grain to fill domestic and export needs. U.S. agriculture is now beginning to realize the benefits of lower prices.

The National Grain and Feed Association has previously taken the position that with competitively priced commodities, the United States will *gradually* return to its preeminent position as the primary supplier of grain stocks to the world. We believe that the generic certificate program is a positive step in the direction toward that goal.

With this as background, I would like to focus this discussion on generic certificates, concentrating on the "pros and cons" of the program.

Clearly, the generic certificate program is not a panacea for U.S. agriculture or federal farm policy. But it is the most effective tool in USDA's arsenal for allowing U.S. grain prices to reach competitive levels in world markets and generate the "free" stocks necessary to meet that increased demand.

By providing farmers with marketing alternatives beyond the price support loan program, generic certificates have effectively expanded "free" stocks. It is critically important to U.S. agriculture that we continue the generic certificate program at present levels or even expand their use to allow this competitive mechanism to work properly.

A direct correlation exists between the supply of generic certificates in the market and the pricing and price competitiveness of U.S. grains, both domestically and internationally. Operating within the framework of the 1985 Farm Act, and given the momentum which has been achieved in U.S. agriculture, in terms of price and demand response, we believe that it would be a strategic mistake to scale back the generic certificate program.

There are several reasons the generic certificate program is successful, and that we believe it should be continued.

First, the generic certificate program encourages producers to redeem loan grain, and thus creates competitively priced free stocks. This will decrease forfeitures of grain to the Commodity Credit Corporation, should reduce foreign production incentives, and increase demand for U.S. coarse grain and wheat.

Second, the generic certificate program provides producers with new marketing options.

Third, the generic certificate program implements a mechanism through which the market can competitively acquire CCC-owned stocks and commodities held in the producer reserve.

Fourth, the generic certificate program provides a tool to alleviate storage congestion and reduce the need for the federal government to relocate grain.

Let me elaborate on each of these.

I. The generic certificate program encourages producers to redeem loan grain, and thus creates competitively priced free stocks. This will decrease forfeitures of grain to the Commodity Credit Corporation, should reduce foreign production incentives, and increase demand for U.S. coarse grains and wheat.

As mentioned earlier, the ability to compete internationally is important not only in terms of the U.S. agricultural economy, but also in terms of the U.S. balance of trade. International agricultural trade is not bound by our domestic payment levels, but rather by competitive prices and delivery terms.

Generic certificates essentially have removed the price support umbrella from U.S. coarse grains and wheat. This has made the United States more competitive in international grain markets and has expanded exports. Recently, nearly 4 million metric tons of U.S. corn was purchased by the Soviet Union. In the absence of com-

petitive U.S. feed grain prices, the Soviets likely would have sought out other more competitively priced feed grains. This was exhibited earlier this crop year when the Soviets purchased record amounts of feed wheat from the European Community and Canada at prices well below that of U.S. corn. The price-reducing function of generic certificates has permitted U.S. prices to drop to levels considered attractive by Soviet purchasers. Without these purchases, U.S. carryover stocks of corn would be 4 million metric tons higher. These stocks likely would have been forfeited to the CCC and carried in inventory at an estimated annual expense of $60 million to $70 million.

Domestic consumption also has increased in response to lower prices. Early estimates for crop year 1986–87 conservatively peg U.S. domestic disappearance of corn at approximately 5.6 billion bushels or 250 million to 300 million bushels over 1985–86 levels. This is grain that will not be forefeited to the CCC thus reducing their potential exposure for storage and interest payments. The annual expense to inventory for this grain would have been $125 million.

II. The generic certificate program provides producers with new marketing options. The ability of producers to market their crops in the most advantageous manner is greatly enhanced by the generic certificate program.

In a simplistic analysis, under our traditional price support loan program, prices probably would remain in a range close to the arbitrarily established loan rate. Prices would work in such a manner as to force residual or surplus stocks into the reserve program or into the hands of the CCC where they are isolated from the market. "Free" stocks would in all probability be minimal.

With the implementation of the generic certificate program, producers now have another important marketing alternative. They can exercise their options to take advantage of the so called "PIK and Roll" program to liquidate price support loans. Under this program, a farmer is permitted to obtain and then repay a CCC loan using certificates. At this point, a brief review of the various programs and options available to producers might be in order.

Option 1.—The first option available to a farmer is to choose not to enter government programs and thereby compete on a price basis in the open market. However, given current price levels, the producer has very strong economic incentives to participate in the government price support programs.

Option 2.—Under a second option, a farmer may, some time after harvest, place his crop in the CCC price support loan program. In exchange for the now collateralized crop, the producer receives a nine-month loan of $1.84 per bushel adjusted to a local county rate. During the loan period, the farmer is responsible for storage costs and interest on the loan (currently 5⅞ percent). At any point during the nine month loan period, the producer is permitted to repay the loan plus interest in cash, thus redeeming the commodity pledged as collateral. Generally, market prices must be greater than the $1.84 plus interest to induce producers to redeem the loan. This is the price umbrella effect described earlier.

At the end of the nine-month loan term, a producer has the option to redeem the collateral and consume it or sell it on the open market, enter an extended loan or reserve program, or exercise the option to forfeit the commodity to CCC. If the grain is forfeited, CCC waives the interest expense to the producer and assumes ownership of the commodity. The responsibility for storage and interest then falls exclusively on the Federal Treasury.

Option 3.—Under a final scenario, a farmer employs virtually the same decision-making processes outlined above, except that he is permitted to repay the loan using generic certificates. A farmer acquires generic certificates by either accumulating them through government deficiency, conservation reserve, paid set aside and other federal farm payments, or by purchasing them in the open market. Generic certificates paid to farmers are dollar-denominated instruments redeemable by farmers for cash, by any holder for CCC-owned commodities, or can be used to pay off CCC price support loans.

The value of CCC-owned commodities or commodities under CCC loan, is calculated in a manner designed to reflect the actual marketplace. For example, prices paid at terminal markets are noted by CCC and then backed off to county locations taking into account the theoretical costs incurred in marketing channels (transportation, etc.). This county local price or "Posted-County-Price" (PCP) is the price value of commodities under CCC loan in that local marketing area. The PCP fluctuates to account to marketplace demands at terminal locations.

To repay price support loans with generic certificates, a farmer will take the certificates to his local ASCS office and use them to redeem his commodities valued at the PCP. By repaying the loan, the grain pledged as collateral is released and avail-

able for sale on the open market. The diagram in the appendix of this testimony indicates graphically how this process occurs.

III. The generic certificate program affords a mechanism through which the market can competitively acquire CCC-owned stocks and commodities held in the producer reserve.

Price support loan rates that have been out-of-line with world market levels and a farmer-owned grain reserve program that during the early 1980s encouraged the isolation of grain from the market. These programs have combined to create a massive influx of grain into government ownership. In fact, in the case of the farmer-owned reserve, it was not until enactment of the 1985 farm law that a ceiling was placed upon the size of the reserve. As of March 11, there were more than 1.3 billion bushels of corn and 650 million bushels of wheat enrolled in the farmer-owned reserve. Under traditional programs, commodities in the producer reserve program or under CCC ownership are obtainable by the market only at reserve trigger prices or CCC resale price levels, both considerably above market price levels. From the government perspective, the storage and interest costs for those commodities were likely to accrue indefinitely.

We submit that generic commodity certificates offer the only vehicle currently in place for bringing about a reduction in those excessive levels of stocks. This ability is vitally important during periods of time when large acreage set-asides are utilized to limit production. During those times, these stocks must be available to the market at competitive levels. Generic certificates provided access to those stocks in a manner not disruptive to the marketplace. During the past 12 months, generic certificates were used to redeem approximately 250 million bushels of CCC-owned inventory from pre-1985 crop years. The shift in ownership of these commodities relieved the Federal Treasury of an estimated annual expense of $125 million in storage and interest costs. .

IV. The generic certificate program provides a tool to alleviate storage congestion and reduce the need for the federal government to relocate grain.

The market-based movement of generic certificates to locations of greatest need permits the market to respond quickly and precisely to locations where storage conditions are tight and there is a need to free up space. By providing an opportunity to purchase CCC-owned inventory and loan grain, generic certificates facilitate the country elevators' ability to meet their producers' needs for permanent and temporary storage space.

The impact of generic certificates on storage problems was first apparent during last fall's harvest. Significant amounts of storage space were created last fall via the purchase and resale of CCC-owned or controlled grain by the marketplace using generic certificates. In addition, the PIK and Roll program provided producers with an incentive to take title to and merchandise grain that otherwise would have remained under loan. For example, 400 million bushels of 1985 crop corn and 59 million bushels of 1985 crop wheat remaining under the loan program were redeemed using generics.

Current USDA data show that of the 4.456 billion bushels of 1986-crop corn entered into the loan program, 995 billion bushels, or 22.3 percent, have been redeemed. During the comparable period for 1985-crop corn, only 49 million bushels, representing 1.7 percent of the 2.865 billion bushels of corn enrolled under loan, had been redeemed.

It has been estimated that without generic certificates, CCC last fall would have faced the prospect of reconcentrating approximately 1 billion bushels of grain from areas with acute storage shortages to regions where storage was available. The cost of relocating that grain could have run in excess of $750 million. Because of the success of the generic certificate program, CCC plans to increase its reliance upon generics to assist in the stock relocation process prior to the upcoming harvest. In fact the grain industry has been notified by ASCS that it will not honor warehousemen's requests to physically reposition CCC-owned stocks this year. This will necessitate the use of generic certificates to free up space now taken up by CCC-owned stocks.

The function of generic certificates as a tool for freeing storage space has implications for grain quality too. In many instances last fall, generic certificate PIK and Roll activity precluded the need to utilize ground storage. Grain properly stored and handled will be much more likely to be merchandisable if and when it ever does enter CCC inventory.

It cannot be disputed that loan and CCC-owned grain redeemed at levels below the governments acquisition cost, and the inducement for producers to become program participants causes increased cash outlays in the short term. Further, the CCC forgoes interest charges on redeemed loan grain, and there are administrative costs which add to the program's expense.

However, to the extent that certificates are utilized in lieu of cash for program payments, the Federal Treasury is substituting agricultural commodities, which it has in great surplus, for one in which there is a relative scarcity, cash. To the extent that the government uses generic certificates, it avoids having to borrow money and incur interest expense. This becomes rather substantial when you consider that several billion dollars of generic certificates will be issued this year.

Additionally the certificate induced increased domestic usage through greater feeding and processing activities generate additional U.S. business activities and should result in a significant increase in new taxable income that would not have existed but for the increase in demand and lower input costs.

Over the long term, the benefits of becoming more market competitive from a price standpoint and operating in a "free" stocks environment are greatly pronounced.

Exports are beginning to increase. One interesting fact about the corn sale to the Soviets, referenced earlier, is that this year the Soviets were benefited by greatly improved crop yields and had already purchased a great deal of feed quality wheat from our competitors (Canada and the European Community) when we were still price uncompetitive. The fact that U.S. sales were made, indicated that, at least for corn, we are now competitive. Our lower prices have also drawn a response from our competitors—Thailand and Argentina have reduced their corn acreage this year.

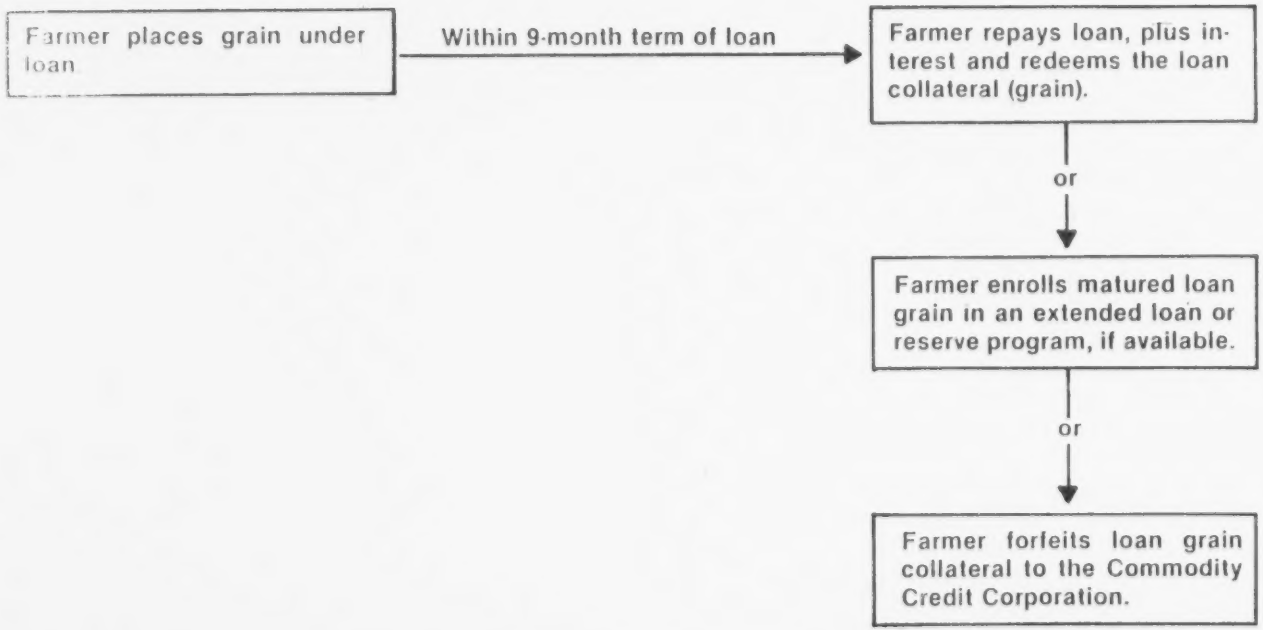
The generic certificate program has also put additional pressure on our trading competitors. A "free" stocks environment has the benefit of creating more price uncertainty for our foreign competition. The European Community, long protected against price declines by our loan price "floor," is now faced with a large budgetary exposure to fund agricultural subsidies to match our price. This should significantly aid U.S. negotiators in the upcoming GATT discussions in Geneva.

Mr. Chairman for the grain marketing industry, the key aspect of generic certificates is competitiveness. If we are to recapture lost markets and create new ones, and reduce the level of our excess stocks, we must be price competitive with the rest of the world. We must be price competitive in world markets or face the unpleasant alternatives of either continuing heavy agricultural subsidies or a substantial reduction of our agricultural economy. Either of those alternatives involves price tags much larger than that being considered here today.

Mr. Chairman, in recognition of the fact that several complete generic program analyses are soon forthcoming from the Congressional Budget Office and General Accounting Office we respectfully ask the record remain open to permit time for study and response to those analyses once they are released. Thank you.

Appendix 1

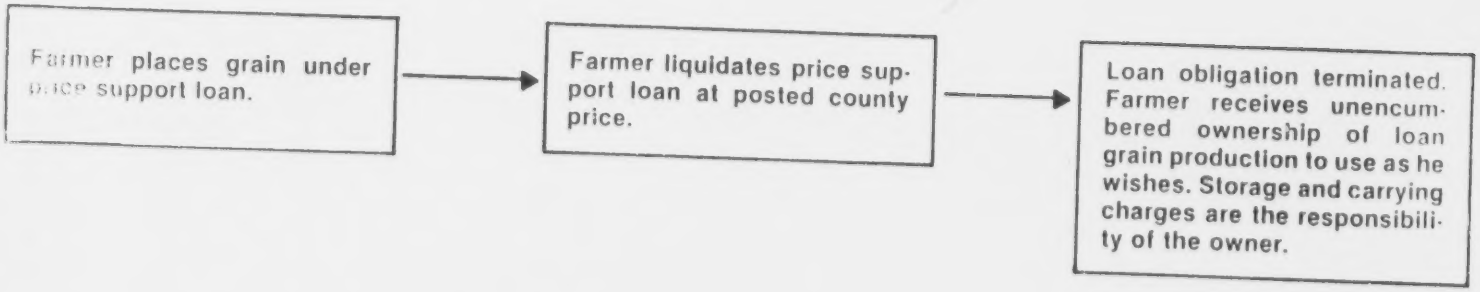
Traditional Price Support Loan Program


Farmer places grain under loan
Within 9-month term of loan
Farmer repays loan, plus interest and redeems the loan collateral (grain).
or
Farmer enrolls matured loan grain in an extended loan or reserve program, if available.
or
Farmer forfeits loan grain collateral to the Commodity Credit Corporation.

Appendix 2

Producer Options Under Generic Certificate Program

1. Producer redeems certificates for cash at face value.
2. Producer sells certificate in open market at market price (currently face value plus premium.)
3. Producer obtains/liquidates price support loans with generic certificates.


Farmer places grain under price support loan.
Farmer liquidates price support loan at posted county price.
Loan obligation terminated. Farmer receives unencumbered ownership of loan grain production to use as he wishes. Storage and carrying charges are the responsibility of the owner.

STATEMENT OF JAMES MOSELEY, CLARKS HILL, IN

I have been asked to explain the use of generic payment in kind certificates as they relate to a grain/livestock farm. Our operation is involved in the production of corn, beans, and hogs. Since the beginning of the certificate idea 1 year ago, we have used "certs" in four different ways;

1. As PIK certificates became available from a deficiency payment, we have sold them for cash. At the time we had no need to redeem corn from loan and the conversion of the certificate to cash was a positive factor to our cash-flow. This has become very easy to do because of a daily certificate market at local grain markets.

2. Certificates received for deficiency payments were used to redeem corn for feed. For the past year we had all of our production under loan. We were able to release bushels of corn from loan by using the formula: face value of the certificate divided by the county price. Our second most reasonable alternative would have been to buy the corn in the open market and transport this corn into our feed processing facility. This would add $0.09/bushel to our cost because of transportation charges.

3. Because we don't receive enough PIK certificates via deficiency payments to redeem all our feed needs, we have bought certificates recently at a premium to their face value. We have been willing to do this because of transportation charges. Again our alternative could be to leave our production corn under loan, plan on forfeiting at loan muturity, and buying corn as we need it for feed from the open market. The cost of this alternative would be $.18/bushel because we've had to transport purchased corn into and forfeited corn out of our farm. Because of this transportation cost, I am willing to pay 110% of the face value for a certificate.

4. Finally, because we need our farm storage empty for harvest next fall we have decided to sell all the corn over our feed needs. The method used is contracting the corn for delivery at a price, buying certificates, and redeeming the corn from loan. An actual example recently completed would be: corn contracted at $1.61, certs at 109%, and C.P.C. at $1.46. The effective price of my purchase to redeem would be $1.46 times 109% = $1.59. Since the sale price was $1.61, we would profit $.02/bushel. In this case we sold 20,000 bushels we cannot feed or store through next fall harvest. We made $400 and most important, emptied our storage.

The above examples point out the flexibility the certificate has given us to manage our grain inventory. The important point is these options are available to all farmers irregardless of size of operation. For example, last week a young man in our area came to me with a proposal. He's trying to start farming (reasonably good timing, I think) and he wanted to rent a farm of about 300 acres, but he had no grain storage. I was impressed with his skill to analyze the economic value of storage on his per acre return. Actually it was going to cost him $23/acre to rent storage, however, if I would agree to lease him a grain bin on a short term basis, he had figured he could "PIK and Roll" during harvest. What this meant was he could contract the corn for fall delivery, obtain PIK certificates from deficiency payments and purchase, put the corn under loan at harvest, and immediately redeem and deliver the corn. He believed he could save the $23/acre and that was the difference he needed to rent the farm. He will be a new farmer next year.

There has been some criticism about certificates because they are difficult to understand. This has some foundation. It took some study on my part when they were first introduced, however we learned quickly because they are part of the business. Almost immediately ASCS offices, the farm media, the grain trade, and agricultural schools in our land grant system began to make available good information on how to use the certificate. There should be little reason for a farmer to not understand their use because of lack of information. There is a greater concern for the lack of understanding about the dynamics within the market as the variables of supply and demand for the commodity, storage, and certificates interact with one another. I think, however, this is typical of any new market factor. It does take some time for administrators and economists to sort out cause and effect. It seems we are beginning to understand.

One rather difficult thing occurred during the last fall harvest which I fear reflects poorly on the certificate. The "Dakota shuffle", as it was finally called, was a situation which developed because two potentially good provisions which gave farmers flexibility to move grain in storage deficient areas, became married. The honeymoon was great, but fortunately the incompatibility was recognized at the same time the marriage announcement hit the front page of the popular press. The reaction within USDA was swift and fair, and the divorce is final. I have some concern though the certificate was considered the problem when it was only the mechanism. This would be unfair.

I have tried to exhibit the usefulness of the PIK certificate in managing the flow of grain away from the farm. Certainly not every farmer would agree, but those I have visited with are positive about their experience. There has been some confusion about how to use them, but this also is coming to an end. We have fixed a negative use as it related to the substitution rule. The remaining issue I want to address is the ability of the American farmer to compete. Above all else, if we are to have a viable agriculture in this Nation, we must become competitive.

It seems to me we currently have three alternatives on the continuum. At one end is a loan program with a fixed price. At the other end is a potential marketing loan. The ability to use generic PIK certificates is a compromise in the middle. Unfortunately, the fixed loan is more of the same we've experienced in the past. If the market price of corn, for example, is under the loan, there is no mechanism to allow the grain into the market until the loan rate is reached. If this does not occur, my best economic option is to forfeit the corn to a CCC delivery point. At this time the real problem begins to occur because the release price for that grain is so high as to insulate it completely from the market. Government costs for storing grain effectively reduces its inventory value by the storage costs. The worse problem is as an exporting country we are out of the market until others free stocks are gone. This action has not improved our ability to compete.

A marketing loan, on the other hand, would do the most in the least time to improve our competitive edge. Prices would drop quickly to market clearing levels and demand would increase significantly. Government budget exposure, though, would increase and in this budget conscious time, I think we could politically have a problem. I strongly support the idea, but I question if it can be done. The PIK certificate seems to be a middle road that accomplishes some of the desirable characteristics of a marketing loan, particularly if it can continue to be complemented with export enhancement. With respect to cost it seems that we must accept the "pay now or pay later" philosophy. If we restrict the flow of grain via a rigid loan program, the costs to government for storage must accumulate at a rate exceeding $.35/bushel/year. With the PIK certificate, some of this crop will be forced into the market instead of a grain bin. This must offset considerable governmental costs. It should also help reduce the overbuilding of storage capacity. I would think it unlikely we want this level of carryover for an extended time. We budget payout to storage capital over a four year period. As a farmer I have little interest in building 150% of our storage needs if I'll not need it two years from now. I suspect my friend that owns a country elevator feels the same way.

One final comment before I summarize. I think we must be certain in this discussion that we differentiate the solution from the problem. As I see it, the generic certificate is only the symptomatic relief for the real problem, the continued oversupply of grain. A good analogy would be it's the "Vicks cure for the common cold." We must keep pneumonia from occurring by sending the correct signals to farmers domestically and internationally. A 0/92 proposal would make sense for 1988. An acceleration in the reduction of target prices would be in order, particularly since decline in production costs have exceeded expectations for the past two years. Finally, and most important, we must send a price message to the world that strongly suggests we'll not tolerate continued expansion. A certificate PIK will help send this signal by lowering prices of commodities available to the market.

In summary, as a farmer, I continue to support the use of generic PIK certificates. They provide a service to the industry to keep a supply of grain available at a cost that is likely comparable to storing forfeited corn for several years. They can relieve the storage problem in deficient areas because they are much easier to mail several hundred miles than to ship the commodity. They are easily negotiable and provide liquidity to the market. Finally, certificates help send a price message to the world. Certainly the system they work in could be improved. For example, it would be helpful to me if I knew how many, and in particular, when additional certificates will be issued. We also need to make certain the differentials between terminal markets are "smoothed out" to assure equal opportunity to different geographic areas. Except for the need though to make some minor adjustments in the system, they're working just fine. Thank you for the opportunity to speak.

STATEMENT OF LAWRENCE N. NEUMANN, PRESIDENT, GRAIN MARKETING, BENSON-QUINN CO., REPRESENTING THE NATIONAL GRAIN TRADE COUNCIL

Mr. Chairman and Members of the Committee, my name is Lawrence N. Neumann. I am president of grain marketing of the Benson-Quinn Co., a regional grain merchandising firm headquartered in Minneapolis, Minnesota.

I appear before you today representing the National Grain Trade Council. I am a member of the Council's Board of Directors. We appreciate this opportunity to express its views on the Department of Agriculture's generic certificate program.

The Council is a national trade association whose regular members include grain exchanges, boards of trade and national grain marketing organizations. The Council has a number of associate members representing a broad cross-section of the grain marketing industry.

We come before you today to discuss the efficiency of USDA's generic certificate program. In our view, the program has clearly benefited farmers, the marketing system, and the government. We will present for you today our assessment of the certificate program reviewing the program's purpose, how and to whom certificates are made available, how the certificates may be used, the benefits of the program, and the disadvantages of the program.

The purpose of the generic certificate program was to reduce government budgetary outlays. Congress drafted the 1985 Food Security Act in an environment of growing and burdensome crop surpluses with an increased awareness of program costs and the need to reduce government outlays. Congress reasoned that paying some farm program costs in government-owned stocks would reduce budget outlays. This is true for several reasons: (1) the government had already paid or issued loans for the CCC-controlled commodities, and distribution of government assets/stocks is not counted as a current budget expense; and (2) the government would be relieved of the costs of storing, handling, and transporting these stocks, whether CCC-owned or loan grain. I feel compelled to point out that the certificate program is a means to reduce government costs and provide more efficient management of government-held commodity inventory. The generic certificate program does not or was not intended to address fundamental policy reforms that are needed. Make no mistake, we believe the program has contributed significantly toward more market orientation with many important effects. But, it is not a substitute for pursuing those needed reforms. However, it provides more market orientation while leaving in place traditional farm programs.

Under USDA's generic certificate program, certificates are primarily made available to farmers, but also to merchants. From April through December 1986, the Commodity Credit Corporation (CCC) issued $3.85 billion in generic certificates. About $3.61 billion went to farmers as deficiency and diversion payments, $83 million went to farmers through the Conservation Reserve Program, about $92 million were issued to merchants through the Export Enhancement Program (EEP) and Targeted Export Assistance (TEA) program, and $54 million were issued to ethanol producers.

A farmer has essentially three opportunities for using certificates he receives: (1) he may use the certificates to redeem grain he has placed under loan, (2) he may sell the certificate, or (3) he may redeem the certificate for cash from CCC. A farmer could also use his certificates to purchase CCC stocks, but CCC has a large minimum quantity requirement that effectively limits such exchanges to merchants.

A merchant's options for using certificates are more limited than a farmer. A merchant can sell his certificates or use certificates to buy CCC stocks.

The Council believes there are many benefits flowing from the generic certificate program. The overriding advantages are improved demand for some U.S. grains and as a tool to deal with the significant storage problems in the Midwest, both of which aid the U.S. farmer.

Farmers can realize several specific economic and management benefits from generic certificates. A farmer can profit if the posted county price (PCP) is less than the loan rate. For example, if the PCP is $1.63 per bushel and the loan rate is $1.84 per bushel, the farmer can use certificates to redeem grain he has under loan at $1.63 PCP which cancels the loan. The farmer's incremental earnings on such a transaction would be the difference between the PCP and the cash market price at his local elevator. This incremental amount has typically ranged from a negative 5 cents per bushel to a positive 10 cents per bushel. Thus, the farmer who is eligible for the $1.84 loan, receives that loan value, plus or minus five to ten cents, depending on local circumstances. In addition, the farmer without sufficient on-farm storage can save the out of pocket expense of commercial storage which is about 30 cents per bushel.

A farmer may also, by exchanging his certificates for grain under loan, save on interest payments. If he sells the grain purchased with the certificates he will save on interest as well as avoid storage costs. A farmer can use certificates to move his old crop out of storage and make room for the new crop.

Because of these many advantages, other farmers have benefited from certificate premiums that have ranged from 5 to 30 percent. For instance, farmers in the

Southeastern portion of the United States who were ravaged by drought last year were able to sell their certificates for a premium on the face value to farmers in the Midwest who needed the certificates to alleviate their storage problems which were brought on by a bountiful harvest.

The certificate program also has disadvantages for the government that have caused questions and scrutiny. Generic certificates have caused some increased federal expense. While the farmer benefits from a difference in the PCP and the loan rate, the government is disadvantaged because the loan is repaid below the loan rate. Certificates can cause some "recycling" causing more grain to be placed under loan than usual because of the program benefits. And larger free stocks mean lower market prices and larger deficiency payments.

Despite these shortcomings, the Council believes the benefits clearly outweigh the disadvantages. In the first instance, while larger free stocks may tend to depress market prices, this lower price is more than offset to farmers by the benefits of the generic certificates. The lower market price has been a boon for domestic demand, providing a substantial benefit to the large portion of argriculture who raise and feed livestock. From the government's perspective, it saves money in many ways with the certificate program. With certificates, the government in many instances is not forced to physically relocate stocks from congested storage areas in the Midwest. By eliminating this movement, the government may save up to 75 cents per bushel in additional costs. Certificates provide the government with a more efficient tool to manage its inventory. By moving government stocks into private hands, CCC saves on storage costs. We should not forget the government has still saved on cash outlays by paying farm program benefits in commodities rather than cash.

From the National Grain Trade Council's perspective, the most important aspect of the generic certificates is the increased market liquidity, free stocks, and more competitive price. The certificate program has been singularly important at a time of sluggish corn exports. We are now, with certificates, competitive in the world market for corn as illustrated by the recent sales to the People's Republic of China and the Soviet Union. In addition, the U.S. share of South Korean corn imports has rebound dramatically. There is absolutely no doubt that without the generic certificates, we would have a disastrous, rather than merely a dismal, corn export picture, as is the case in soybeans where U.S. exports are declining.

The generic certificates have sent the signal to our competitors that the United States will be competitive in world corn markets. This has served to limit the enthusiasm of our feed grain competitors to increase their production to take advantage of the price umbrella the U.S. has provided in the past.

Generic certificates have worked well for corn, but have not proved as effective for wheat and soybeans. There are two reasons for this. The first is that certificates are used to address the storage situation and corn storage poses the biggest problem. The second reason is what we call the multiplier effect. If certificates are trading at 105 percent of face value, that translates into a 7.5 cent premium for the certificate if redeemed for corn. When you translate 105 percent to other, higher-priced commodities the premium becomes larger in dollar terms, 25 cents for soybeans and 12.5 cents for wheat. Thus, corn is more attractive because of the lower price and premium value.

The Council believes agriculture would be better served by expanding the generic certificate program. The closer to par value or 100 percent the certificates trade, the more likely they are to be used for all grains, rather than just corn. Expanding the program would expand market opportunities for all grains, both domestically and for export.

The Council believes there is no question but what the generic certificates have increased farmer income, improved demand for U.S. grains, and aided USDA in cutting overall costs and in implementing a market-oriented program.

Mr. Chairman, thank you for the opportunity to share the views of the Council with the Committee.

STATEMENT OF MERRILL D. MARXMAN, PRESIDENT, MARXMAN AND ASSOCIATES, INC.

Mr. Chairman, I am pleased for the opportunity to testify before this distinguished committee on generic certificates, a subject I believe is very important to the agriculture community in this country.

As a consultant to farmers and the agribusiness industry, I am involved daily on many agriculture issues. The comments I receive from almost everyone I talk to about generic certificates reflects a very positive acceptance. In fact the question I

am asked most is: Will the generic certificates continue to be part of USDA's payment plan?

You have or will hear arguments and debates from some that the use of certificates is more costly than cash payments and that certificates have been abused with the substitution/PIK and Roll that occurred last year.

I will share with you today, my personal views on why certificates should continue to be used.

Beginning last fall, we witnessed the dawn of the generic certificate in grain merchandising. What follows is our assessment of the usefulness of certificates in grain storing and marketing.

First, we would like to state our firm belief that if American agriculture is to prosper, our grain prices must be world competitive. To ensure this, prices must be allowed to go below loan support prices if world prices are below the loan. Our experience last fall, especially in the corn belt, was that certificates were used precisely to this end.

In the past, producers faced with prices below loan would avail themselves of a Commodity Credit Non-recourse Loan rather than sell. The original concept of the Commodity Credit Loan was to offer the producer the cash flow to see him through to a better selling opportunity. The reality had become that U.S. production was held hostage above market prices by the loan and that producers throughout the world looked to our loan as a price umbrella for their production.

Beginning last fall, producers were offered an alternative to this self defeating loan/store syndrome. By use of a strategy popularly called PIK and Roll the producer would take a Commodity Credit Loan, use certificates to immediately redeem his pledged collateral and then sell the commodity at market prices. If the cost of redeeming the loan was equal to the sale price, the producer would realize loan price without the need or expense of strong the commodity for the 9-month term of the loan.

Record yields and record inventories had brought both farm and commercial storage to a saturation point. With storage either unavailable or too costly, many producers chose to PIK and Roll. This had several effects. One effect is commodities moved into the market at prices at or near world prices but certainly below loan levels. The fruits of this are just beginning to appear in increased domestic usage and brighter export prospects. Another effect of the use of certificates, a corollary to the grain movement, was alleviation of the storage shortfall brought about by another record yield. Finally, demand for certificates increased and they began to sell at premiums to their dollar face value. Since the bulk of the certificates were issued to producers, most of this increased value went to producers.

We view all of these results of certificates as positive for the agriculture community, and we continue to see certificates used to an advantage. Producers holding Commodity Credit Loans must either pay off their loans or forfeit the grain to commodity credit at the term of the loan. Many producers are finding opportunities to redeem their loans using certificates and marketing the grain. Again, realizing most of the loan price. Producers are solving a storage problem before it even arises, the CCC is eliminating the liability of acquiring additional inventory, and grain continues to flow to market at or near world competitive prices. The framers of this system should be thrilled.

There are suggestions that the certificate system is too costly and should be abandoned. The first question is too costly compared to what? We repeat, if American agriculture is to prosper we cannot return to the old static loan system. It's a proven failure in competition for world markets.

New concepts have been put into the marketplace by the government that makes the traditional sources of supply less important. Further, the government stocks, once considered a relatively static quantity in supply/demand analysis is now a dynamic quantity which can change significantly from month to month. The vehicle, that makes government controlled grain stocks dynamic, is the generic certificate.

In the United States, we are no longer trading on the basis of grain supply and disappearance, but on the availability of each grain type, given the economic demand for generic certificates used for each, and all the CCC owned commodities and commodities under loan to CCC.

Generic certificates are influencing domestic corn and wheat markets this marketing year and the upcoming crop year by increasing the level of free supplies. Certificate exchanges for both wheat and corn are expected to increase significantly through the summer. Exchanges for wheat are estimated to total near 325 million bushels during the 1986/87 spring and summer quarters, compared with about 265 million bushels to date. Corn exchanges could exceed 1.5 billion bushels during the

spring and summer quarters, about the same level of exchanges for corn made thus far.

Pricing decisions by the CCC will be the primary determinant of the proportional use of generics for converting paper into grain.

The general grain supply/demand tables are still the basic tools for quantifying the sources of supply and uses of grain in the United States.

A brief overview shows that the supply of grain in general comes from:

1. Normal farmer marketings which are broken down into: Cash sales, loan redemptions using cash, loan redemptions using generic certs (commonly referred to as PIK and Roll), CCC grain swaps, CCC catalog sales using generic certificates.

2. Suppliers of the grain can be the traditional farmer, commercial in the trade, or even any speculator who has converted generic certificates into commodities. It is important to understand that generic certificates are traded in an over the counter market (within the trade), have no theoretical maximum value and have a cash redemption value of par (or 100 cents on the dollar).

An important point one needs to understand, is that USDA changes its price of grain daily for loan grain, and by the minute (hourly) for CCC grain. Changes in pricing grain could:

(a) Change the free supply/demand expectations for grain.

(b) Because of (a), change the supply expectations for grain.

(c) Price all CCC grain away from current markets, i.e., cut off all sales to the market.

(d) Price all CCC stocks at below market levels on a relatively equal basis.

Certificates have proven to be a significant means of moving stocks into the market place. This fact controverts and weakens the argument that certificates encourage producers to obtain CCC loans. In clarification, for example, in 1986, 79.4 percent of the eligible crop acre base was signed up in ASCS's acreage reduction programs. This made the production on the permitted acres on those farms eligible for CCC price support loans. Low market prices left the producers with no choice but to put their commodities under loan to CCC. Without certificates, not only would the commodities be placed under loan, but nearly all of the commodities would be forfeited to the government. Certificates provided producers with the option of redeeming loan grain at market prices. It would be fair to state, however, that producers such as livestock feeders, dairymen, etc., who historically would not put grain under loan would do so to take advantage of the economic margin certificates provide. This is a small price to pay when compared to the overall benefits of generic certificates.

The government controls approximately 92 percent of the stocks in this country which includes approximately 50 percent of government owned stocks and approximately 42 percent of farmer owned grain under loan. The stocks owned by the government are virtually shielded from the market because they can only be sold at the statutory minimum sales price. Certificates add an additional avenue by which commodities can move into the commercial channels, thereby reducing the amount of commodities going into government inventory and/or reducing the amount of government inventory.

As of March 11, 1987, through the use of certificates approximately 2,019.2 mil. bu. of grain moved into commercial channels. Approximately 270.9 mil. bu's. of government owned grain were exchanged for certificates, and 1,748.3. mil. bu's. were redeemed by farmers with certificates. If the use of certificates were not available the government would be paying storage and handling charges and administrative costs on that grain today or at some point in the future.

Government stocks are expected to increase by 40 to 50 percent from November 1986 to November 1987. Total government stocks could be between 4.5 to 5 billion bushels by the end of 1987 which would result in a continued storage problem in high production areas, this fall. USDA officials have already announced they are looking to farmers and warehousemen to merchandise their way out of the anticipated storage crunch through the use of certificates.

Certificates have acquired a bad name because of substitution/PIK and Roll that was used by the agriculture community last year. USDA procedure that was in place prior to certificates, permitted producers in storage shortage areas to substitute grain under loan or grain eligible for loan to make storage space available. Producers using the substitution provisions could go in to another county or state and acquire grain to use for substitution. The loan rate and differentials of the new county would be used when the loan for the substituted grain was computed and then redeemed with certificates. The producer realized a windfall if the loan rate was higher than the original loan and if the differential was greater at the new

county. USDA closed the loop hole which permitted that activity when they implemented a policy that grain substituted is ineligible for redemption with certificates.

We believed a change was needed but USDA went too far. USDA could have and still can accomplish the same results if they had implemented a policy that the loan rate and the differential of the initial county be used for substituted grain.

A first glance the budget analysis would tell you that the government outlays are increased by as much as 14-15% with the use of certificates. This is because the government, in essence, buys commodities at the loan rate and sells them at the market price which has been less than the loan rate. It is extremely important, when comparing the cost to the government, with the use of certificates versus not using certificates, to consider what it costs the government to own grain. For example, a bushel of corn forfeited to CCC in 1986 would cost the government an average of $2.33 ($1.92 loan rate + $.41 handling and storage charge) for one year. If the grain has to be moved it would cost the government an average of $.46 increasing the annual cost to $2.79 per bushel. Thereafter, that bushel of grain will cost the government approximately $.35 to store which does not include administrative and interest costs.

In conclusion you must ask, what options are available to address the farm problems in which we are facing? Are exports going to increase sufficiently in the short and long range future? Will domestic prices rise above the loan rate? When can producers rely solely on the market place for a reasonable return on their commodities? There are no positive answers to these questions, and until there are positive answers, generic certificates must continue.

STATEMENT OF DEMETER, INC., FOWLER, IN

Demeter, Inc., a 44-year-old Indiana corporation, operates country grain elevators in Indiana, Illinois and Wisconsin. We serve over 2000 producers who are primarily cash grain farmers raising corn and soybeans. Commodity certificates have played a major role in the marketing of grain in our area. Due to the significance of commodity certificates, we respectfully request that the enclosed comments be accepted as written testimony to the Senate Agriculture Committee.

As Demeter's experience with certificates is limited to corn, our comments are directed toward that area.

Commodity certificates are having very important impacts on the corn market. The most dramatic impact is allowing prices to move to market-clearing levels. A second major impact is providing a tool for resolving a storage crisis. In addition, commodity certificates have several unique features which can contribute greatly to the orderly marketing of grain. Each of these aspects of commodity certificates is further explained in the following commentary.

Commodity certificates' impact on prices is by far the most significant. Prior to the advent of certificates, the loan rate acted as a price floor below which no U.S. producer would sell. Instead, the producer would take a loan and forfeit the grain to the government. Over the past few years, loan/forfeit process has had two major results.

First, government inventories have risen dramatically. This is because loan rates were well above market clearing levels. Consequently, a farmer's best "sale" was to take a price support loan, and forfeit the grain to the government.

Second, foreign buyers filled their needs by buying from competing exporters, who were selling below our loan rates.

Commodity certificates have begun to reverse this trend. Less corn will be going into government inventory, and more will be going to commerical users, both foreign and domestic. 1986/87 corn exports are now forecast to show the first year-to-year upturn in seven years.[1] This is encouraging news for those who hope and believe that market-oriented farm policy can work.

In addition to the loan rate acting as a floor for U.S. producers, it acted as a price umbrella for our competitors. Foreign producers knew they would do no worse than selling just below the U.S. loan. This price umbrella was responsible for large increases in foreign production.

Commodity certificates eliminate this protective umbrella. An encouraging item from the USDA's "World Grain Situation and Outlook", harvested area in Canada, Argentina, and Australia (major competitors for world markets) has finally begun to

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[1] See Page 5.—World Grain Situation and Outlook USDA Circular Series FG-4-87—March, 1987.

decrease after a dozen years of expansion.[2] It is imperative that we not re-institute a price umbrella for foreign producers.

The combined effect of increasing demand and discouraging foreign competitors means a larger share of U.S. production will move to market. This saves the federal government tremendous storage costs. The U.S. government is presently paying storage on approximately 4.8 billion bushels of corn, at an annual cost of approximately $1.4 billion. (Bear in mind that this storage cost figure is for corn only.)

Commodity certificates play a vital role in keeping corn competitively priced. Without certificates, we will return immediately to the loan/forfeit cycle and will continue to accumulate massive government inventories with their budget-busting storage costs.

Commodity certificates have played a key role in solving critical shortages of storage space. Last harvest, certificate-based loan redemptions enabled Demeter, and other country elevators, to move grain to market. Had this tool not been available, there would have been insufficient storage space to enable producers to obtain loans on their grain. This year, the problem will be just as severe. CCC has already told warehousemen they will be unable to relocate government inventories to make room for the new crop.

They have told us we will have to merchandise our way out of the problem. Without commodity certificates, we will not have free stocks to merchandise, nor storage space to offer to producers. Without storage space, producers will be unable to participate in the loan program. Commodity certificates are critical to overcoming the storage deficit.

Commodity certificates have other features which make them the most market-sensitive tool of the current farm program. First, certificates can be used to acquire any government-owned or price-support commodity. This means that the markets' needs can be met by the most economical (thus competitive) means. This also means that certificates can facilitate the orderly work-down of our surplus inventories. Second, commodity certificates, being freely traded on the open market, will tend to go to the area of greatest need. If, for example, only one area of the country had a storage problem, producers in that area could bid up for certificates rather than build storage. Certificates can respond to a wide range of needs far quicker—and cheaper—than could detailed regulation or government management of the process.

Certificates have been much-maligned since their inception. Largely, this is because certificates have traded at a premium to face value. Many people believe this is the result of government inventories being under-valued. This is simply not true. The premium paid for certificates is reflective of the buyers' savings on some other item. During harvest, for example, a farmer who takes a loan can either store the corn for 9 months, or use certificates to redeem the loan. The farmer will logically do whichever is cheaper. This farmer is perfectly willing to pay a premium for the certificates, as long as the premium is less than his cost of storing grain, either on his farm or in commercial storage, for 9 months. In other cases, the premium may reflect a savings in transportation or handling expenses. The arbitrary conclusion that government inventories are under-valued is simplistic and inaccurate.

Other causes of criticism of certificates arose with the use of substitution and redemption last fall. There were some definite abuses of the intended uses of certificates. We believe the Department of Agriculture has corrected the loopholes that allowed those abuses.

When considering the budget consequences of abolishing commodity certificates, it is important to examine the budget consequences of the alternatives. If all payments are made in cash, there will be no mechanism to allow prices to go to world market prices. We will return to our previous strategy of trying to artificially support world prices. The effect will be to resume our abandonment of foreign grain markets, while accumulating larger and larger government inventories. This will rapidly prove (again) to be disastrous to both the federal budget and rural economies.

Marketing loans could have many of the same advantages as certificates. However, if marketing loans were implemented, we believe that any attempt to pre-determine cost to the federal treasury would be virtually a guess at best. Certificates are in place, debugged, and working well. Any change at this late stage, with the normal attending problems of a new operation, will place producers in a severe storage bind this fall. We strongly encourage the continued use of commodity certificates.

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[2] See Page 1.—World Grain Situation and Outlook USDA Circular Series FG-4-87—March, 1987.

STATEMENT OF STEVE KOPPERUD, VICE PRESIDENT—LEGISLATION, AMERICAN FEED INDUSTRY ASSOCIATION

The American Feed Industry Association (AFIA) wishes to thank Chairman Leahy and the members of the Committee for this opportunity to comment upon the importance of the U.S. Department of Agriculture's generic (PIK) certificate program, and its value over nominal program cost increases to the farmer, the grain processor and the federal government.

AFIA is the national trade association representing the manufacturers of more than 70% of the commercial primary formula livestock and poultry feed sold annually in the U.S. Our more than 500 member companies and member associations also include firms providing feed ingredients, animal health products, equipment and services to the domestic feed industry.

The domestic feed industry annually purchases between $12-$15 billion worth of feed ingredients, mainly grain, oilseeds and their byproducts. This purchasing level makes the feed industry the single largest user of domestically produced grain and oilseeds. This also illustrates our keen interest in the development of federal farm policy and programs particularly the generic certificate program.

AFIA's statement will deal generally with the successful operation of the generic certificate program as it relates to grain marketing and the simultaneous benefits to producers, processors and the federal government. However, we will highlight a particular use of the certificate program that proved to be a literal life-saver for many U.S. farmers this past year, namely the use of generic certificates in USDA's emergency feed assistance program.

Prior to USDA's implementation of the commodity certificate program, U.S. grain producers were locked into a rigid framework of target price/deficiency payments, fluctuating markets and loan rates. The loan rate program placed farmers in the "do-or-die" position of either redeeming their commodities at low market rates or forfeiting their grain to the Commodity Credit Corporation, aggravating storage availability and increasing the cost of commodity programs to the government.

Farm programs generally provided a direct pricing mechanism for our overseas competitors. It was fairly simple for foreign competition to calculate our prevailing producer return through our loan/target price programs, price just below that level and take U.S. export markets. This is shown most dramatically by the 47% decline in U.S. coarse grain exports for the 1980–1986 period, compared with the over-all world decline in coarse exports of 18%.

During debate over the Food Security Act of 1985, Members of the House and Senate sought methods to remove this straightjacket from American production and exports. The solution was to cut loan levels to free up U.S. production at competitive prices, while retaining the target price/deficiency payment system as the safety valve on farm income. A strong tool provided to the department was the authority given to the Secretary of Agriculture to issue commodity certificates in lieu of direct cash payments to farmers under the loan program.

The commodity certificate program allows coarse grain prices to drop below the arbitrary floor set previously by the loan rate, allowing markets to operate more in line with supply, price and demand. The program permits access to grain supplies previously isolated from the market by government programs.

The general benefits of the program as it now operates are similar to those anticipated by USDA in authorizing the program. They are the following:

1. Reduce CCC inventories and loan stocks. Since the certificate program allows CCC inventories and loan stocks to be exchanged for certificates reflecting actual market levels, this is an incentive to trade the certificates for loan commodities and CCC-owned stocks.

2. Permit access to all commodity stocks. With nearly all CCC-owned stocks available under the certificate program, these commodities become part of the available pool for certificate exchange. Without the certificate program, the price of these stocks would have to rise above the formulated trigger price before they could be purchased.

3. Enhance overseas competition. The grain industry has learned that the certificate program has resulted in lower corn prices, for instance, making U.S. corn more competitive with foreign production.

4. Lower farm input costs. The lower market price for corn and other feed grains benefits the hundreds of thousands of U.S. livestock and poultry producers by reducing the cost of feed, their largest production cost.

5. Lower storage and handling costs. Since certificates are easily exchanged for commodities, CCC stocks fall and there are the resulting savings on storage and handling.

6. Minimize federal cash outlays. Issuing certificates instead of direct cash payments allows the department to avoid cash outlays and the resulting budgetary impact.

FARMER BENEFITS

While the commodity certificate program cannot be characterized as the cure-all for what ails the farmer, it has provided a mechanism that has greatly enhanced the farmers flexibility in marketing, and has had a positive influence on his cash-flow. One beauty of the certificate program is that it is, now that certain initial adjustments have proved successful, a program that can and does benefit all classes of producers.

USDA has testified that the transfer and generic aspects of the program have generated a secondary market in certificates. In this market, certificates have been trading at prices over their initial face value, with premiums ranging from 3–35%. The U.S. General Accounting Office in its March, 1987 report on the program shows that marketing of certificates allows farmers to realize a greater return than if the CCC had issued direct payments in cash.

Also contributing to an enhanced cash flow for farmers is the ability of the producer to avoid storage and transportation costs since he/she can exchange certificates for commodities under price support loan rather than storing collateral commodities.

Another benefit of the program accrues to participants who exchange their certificates for price-support loan crops. The producers may realize an additional benefit if the commodities can be marketed higher than the posted county price.

OTHER BENEFITS

Current price support programs isolate vast amounts of grain from the open market in an attempt to boost prices. These program commodities have traditionally been unavailable to the market until the formulated trigger release price is reached, an uncommon occurrence since this release price is considerably above prevailing market price by design. When this situation is combined with periods of high set-aside to power production, the available grain for domestic and export use is even more limited. Livestock and poultry farmers are faced with reduced feed supplies and higher feed costs under these conditions.

Even if the release price were reached, the sudden "dumping" of such massive stocks would be disruptive to the marketing place. The certificate program provides relief, since it allows, through the exchange of certificates for commodities under government ownership, the orderly influx of these grains into the marketplace. At the same time, the government's cost of storage and handling is greatly reduced as their inventory is drawn down. It's estimated by USDA that the commodity certificate program allowed about 250 million bushels of CCC-owned grain from pre-1985 crop years to move into the market, saving the federal government $125 million in storage and interest costs.

MUTUAL BENEFIT—THE EMERGENCY FEED PROGRAM

One of the ancillary programs for which the commodity certificate program was used was the emergency feed program, established by the Secretary of Agriculture in the wake of the 1986 drought in the Southeast and flooding in the Upper Midwest.

The goals of such emergency programs are always the same: Assist qualified producers who have been economically damaged by extreme weather conditions, and the reduction of government-owned stocks of surplus grain. Historically, such emergency feed allocation programs have been a crazy-quilt of 40-year-old program options, all slightly different, included in various farm legislation as discretionary authority to the Secretary. These programs have also been further confused by various political considerations; hence, no two emergency feed programs have been developed using the same program alternatives in an identical manner.

The feed industry has always been concerned that farmers be afforded the most efficient and timely relief. In most disaster situations farmers have to demonstrate need and the inability to feed onfarm, and are usually offered CCC grain at prevailing county loan prices. The problems occur when natural disasters strike grain deficit and/or storage deficit areas, such as the Southeast in 1986.

The debate centers on whether USDA will sell or donate the grain, whether USDA will pay all, part or none of the transportation costs, and whether or not feed dealers will be allowed to participate in the program by forwarding a commercial

feed up front to the farmer, with inventory grain replaced at a later date by the CCC grain allowed the farmer, the feed price then discounted to reflect the disaster price paid by the farmer for the CCC grain. All of these items are discretionary to the Secretary of Agriculture.

In past programs, the logistics of moving government-stored grain on short-notice into grain deficit or deficient areas proved to be the most overwhelming hurdle. Simply because grain had to be transported from another grain surplus region meant that emergency aid was unnecessarily delayed. Feed dealers and manufacturers, with inventory on hand to provide feed, were usually utilized to provide this feed, but in some cases were deterred from participation because of the same logistical impediment to restoring forwarded inventories.

In 1986, the Secretary of Agriculture decided to use the generic certificate program as the heart of the emergency feed assistance program, and for the first time provided farmers with viable, workable options and the economic freedom to make those choices based on individual needs.

AFIA was concerned relative to the implementation of this aspect of this particular emergency feed program. However, that concern was quickly replaced with satisfaction that the department had hit upon a method of distributing emergency CCC stocks to disaster areas that was both economically sane and minimally disruptive to the market place.

USDA's Agricultural Stabilization and Conservation Service recognized rightly that direct assistance in the form of CCC-owned grain limits a producers flexibility in feed purchases, and tends to preclude the involvement of local feed dealers and manufacturers in the delivery of emergency feed supplies. In many cases in earlier programs, if the livestock or poultry farmer wished to feed a balanced ration, he had to transport the CCC grain to his feed dealer to have it combined with other nutrients, and then transport it back to the farm. This was obviously an expensive and inefficient process.

In the 1986 emergency feed assistance program, ASCS shared with eligible producers the cost of buying livestock and poultry feed, including hay. Those cost-share payments were made to the producers in the form of commodity certificates, permitting the producer his option of buying mixed feed from the dealer or supplier. The feed dealer could accept the certificates as payment from the producer and use the certificate to obtain replacement grain from CCC. Of course, if the farmer chose to take the grain, that was his option also.

By utilizing the commodity certificate program, USDA was able to move feed assistance in the most efficient manner, while saving money for the federal treasury. In previous programs, the market disruption in moving surplus grains in large amounts from one section of the country was enormous, as was the cost of transportation and storage in the deficit area. The commodity certificate program as utilized in the 1986 emergency feed assistance progam virtually eliminated that disruption, allowing feed dealers and manufacturers to assume a role beneficial to the producer and the companies involved. However, the farmer did not have to use the feed dealer and manufacturer if he did not wish to do so.

AFIA wishes to thank the committee again for its consideration of our views. The commodity certificate program, while generating nominal increases in budget outlay ($450 million minus approximately $250 million in transportation, handling, and interest savings), has demonstrated its benefits to producers through greater flexibility and cash flow, to agribusiness through enhanced available supply and marketing opportunity and to the government through reduced surplus commodities and the resultant savings.

NATIONAL ASSOCIATION OF WHEAT GROWERS,
Washington, DC, April 1, 1987.

Hon. PATRICK LEAHY,
Chairman, Committee on Agriculture, Nutrition, and Forestry,
U.S. Senate, Washington, DC.

DEAR CHAIRMAN LEAHY: Since 1986, farmers enrolled in the government price support programs have received payments in the form of generic commodity certificates. These certificates, which are transferrable and issued in dollar amounts, are in many ways similar to direct cash payments. However, the National Association of Wheat Growers (NAWG), which represents farmers from states which produce over 85 percent of the domestic wheat, believes producers can utilize certificates to achieve additional marketing advantages.

Soon after issuance of generic certificates began, a secondary market was created due to the transferrability of the certificates. In fact, certificates have consistently

been trading at a premium which directly goes to the farmer. In addition, by using certificates to redeem commodity loans, producers may achieve price protection and still have control of their grain.

Although some reports associate extra government costs with certificates, the NAWG believes not only do producers benefit but also the Federal Treasury. In using certificates to redeem government loans, grain is not forfeited to the Commodity Credit Corporation (CCC). This means the storing, transporting and selling of the grain will be the responsibility of the producer and not the government.

Specifically for the wheat farmer, receiving generic certificates provides for more marketing options. It allows grain to go to market at the producer's choosing rather than at CCC's request. Grain is marketed in response to demand and can be competitively priced in much the same manner as commodities which enter the market under a marketing loan.

In recognizing the savings to the government in storage, handling, and transportation costs associated with CCC grain, plus the benefits to producers, the NAWG is supportive of the certificate program and believes it helps in establishing a market oriented farm policy.

Sincerely,

JAMES W. MILLER, *President*.

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